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National Securities Exchange Liability to Public Investors: Time to Overcome Inertia?

Charles E. Dropkin*

I. Introduction

A right of action against a national securities exchange for damages is not expressly authorized under section 6 of the Securities Exchange Act of 1934¹ and may be maintained only if it is judicially implied. The first decision holding that public investors may assert a private action against an exchange under section 6 for breach of duty, *Baird v. Franklin*,² suggested such a right of action could be implied under two possible theories. First, under a tort theory, members of the class a statute is created to protect (investors) may sue for damages resulting from statutory violations. Second, under contract theory, investors are intended beneficiaries of the registration statement filed with the Securities and Exchange Commission (SEC) in which an exchange agrees to enforce its members' compliance with the provisions of the Exchange Act and rules promulgated thereunder. Although it did mention the third party beneficiary theory, *Baird* was based on tort theory.

Baird has been followed in several subsequent decisions.³ In *Weinberger v. New York Stock Exchange*,⁴ the contract theory was expressly recognized as a device to extend the statute of limitations. The class of members having standing to maintain a private right of action under section 6 was later expanded through judicial construction of the term "investors." In cases such as *New York Stock Exchange v. Sloan*⁵ and *Hughes v. Dempsey-Tegeler & Co.*,⁶ the courts held that even limited partners of and subordinated lenders to members of a national securities exchange fell within the purview of section 6.⁷ In *Lank v. New York Stock Exchange*⁸ and *Arneil v. Ramsey*,⁹ however, the Second Circuit halted that development and declared that the class of persons having an implied right of action

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1 15 U.S.C. §§ 78a-kk (1976 & Supp. 1978).

2 141 F.2d 238 (2d Cir.), cert. denied, 323 U.S. 737 (1944).

3 See, e.g., *Hochfelder v. Midwest Stock Exch.*, 503 F.2d 364 (7th Cir.), cert. denied, 419 U.S. 875 (1974); *Phillips v. American Stock Exch.*, [1974-75 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,035 (S.D.N.Y. 1975); *Marbury Management, Inc. v. Alfred, Kohn, Wood, Walker & Co.*, 373 F. Supp. 140 (S.D.N.Y. 1974); *Steinberg v. Merrill Lynch, Pierce, Fenner & Smith*, [1973-74 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,599 (S.D.N.Y. 1974); *Caddell v. Goodbody & Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,938 (N.D. Ala. 1972); *Kroese v. New York Stock Exch.*, 227 F. Supp. 519 (S.D.N.Y. 1964).

4 335 F. Supp. 139 (S.D.N.Y. 1971). See notes 125-131 *infra* and accompanying text.

5 394 F. Supp. 1303 (S.D.N.Y. 1975).

6 534 F.2d 156 (9th Cir.), cert. denied, 429 U.S. 896 (1976).

7 See also *Miller v. New York Stock Exch., Inc.*, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,606 (S.D.N.Y. 1976) (limited partner); *Hughes v. Dempsey-Tegeler & Co.*, 534 F.2d 156 (9th Cir.), cert. denied, 429 U.S. 896 (1976) (subordinated lender); *Fischer v. New York Stock Exch.*, 408 F. Supp. 745 (S.D.N.Y. 1976) (subordinated lender); *Carr v. New York Stock Exch.*, 414 F. Supp. 1292 (N.D. Cal. 1976) (private investors in brokerage house).

8 548 F.2d 61 (2d Cir. 1977).

9 550 F.2d 774 (2d Cir. 1977).

against an exchange was limited to *public* investors. The *Lank* and *Arneil* decisions recognized the potential conflict between the interests of public investors and those of member firm investors and their creditors, which could hamper effective exchange regulation.¹⁰

The Supreme Court of the United States has never considered whether a private right of action against a national securities exchange should be judicially implied under section 6 following the tort theory of *Baird* or the contract theory of *Weinberger*. However, beginning with *Cort v. Ash*¹¹ and culminating in *Touche Ross & Co. v. Redington*¹² and *Transamerica Mortgage Advisors, Inc. v. Lewis*,¹³ the Supreme Court has laid out specific tests to determine whether a private right of action may be implied under a federal statute. This article re-examines *Baird* and its progeny in the context of Supreme Court pronouncements on implying a private right of action.

The hallmark case of *Cort v. Ash*¹⁴ involved a shareholder suing individually and derivatively to recover corporate political expenditures allegedly made in violation of section 610 of the Federal Campaign Finance Act, a criminal statute.¹⁵ The Court held that the corporation on whose behalf the shareholder sued did not have an implied private right of action for damages under section 610. The Court summarized the inquiries relevant to determining whether a private right of action should be implied:

First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted,"—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?¹⁶

Noting "the intent to protect corporate shareholders particularly was at best a subsidiary purpose of Section 610," the Court found¹⁷ the other factors either were "not helpful or militate against implying a private cause of action."¹⁸

10 A classic example concerns an exchange's response to a violation of the net capital rule by a member firm. The net capital rule prescribes the extent to which a member's aggregate indebtedness can exceed its net capital and is aimed at ensuring the financial solvency of member firms. To protect customer accounts, an exchange may seek to continue the operation and existence of the member firm (with restrictions such as a proscription against incurring any additional liabilities) to enable the firm's customers to transfer their accounts in an orderly fashion to other brokers. On the other hand, investors in the member firm, depending on their perceptions of the health of the firm, would either demand that the exchange (i) impose no restrictions on the business and allow the firm to work out its problems (premised on the belief that the firm will survive the crisis and that the exchange should do nothing which could impair short-term firm profitability) or (ii) close down the firm (viewing the business as incapable of resuscitation and seeking to minimize overall losses to member firm partners and subordinated lenders). Such tensions between the interests of public investors and investors in the member firms can lead to irreconcilable conflict and place an exchange in a "Hobson's choice" situation.

11 422 U.S. 66 (1975).

12 442 U.S. 560 (1979).

13 444 U.S. 11 (1979).

14 422 U.S. 66 (1975).

15 18 U.S.C. § 610 (1970) (repealed, Pub. L. No. 94-283, tit. II, § 201(a), 90 Stat. 496 (1976)).

16 422 U.S. at 78.

17 *Id.* at 80.

18 *Id.*

In *Piper v. Chris-Craft Industries*¹⁹ the Court applied the same four criteria in determining whether an unsuccessful tender offeror could maintain a private right of action for damages under section 14(e) of the Exchange Act.²⁰ Section 14(e) contains a broad anti-fraud prohibition, similar to rule 10b-5,²¹ applicable to corporate tender offers. Beginning its analysis, "of course, with the statute itself," the Court observed that section 14(e) "makes no provision whatever for a private right of action, such as those explicitly provided in other sections of the 1933 and 1934 Acts."²² Considering the legislative history and concluding it contained no hint Congress had contemplated a private right of action for damages, the Court applied each of the four *Cort* inquiries. According to the Court, the legislative documents merely evinced an intent to curb the unregulated activities of tender offerors. Further, institutional limitations upon the SEC to police all violations "alone do not lead to the conclusion that *any* party interested in a tender offer should have a cause of action for damages."²³

*Santa Fe Industries v. Green*²⁴ dealt with an action by minority shareholders alleging a short-form merger under Delaware law violated rule 10b-5²⁵ because the defendant had sought to freeze the plaintiffs out at an inadequate price and because the merger was undertaken without prior notice to the plaintiffs. Again, the Court emphasized that the starting point in every case involving construction of a statute is the language itself. The Court concluded that the section 10(b)²⁶ language gave no indication Congress meant to prohibit conduct not involving manipulation or deception. Although it regarded the language of the statute as sufficiently clear to be dispositive, the Court found its conclusion reinforced when the *Cort* inquiries were made.²⁷

*Touche Ross & Co. v. Redington*²⁸ marks the Court's most explicit directive regarding the standards for implying a private right of action for damages. Like *Piper*²⁹ and *Santa Fe Industries*,³⁰ *Redington* involved the existence of a private right of action under the Exchange Act. The Court ruled that the inquiry must end if by its terms a statute grants no private rights to any identifiable class and proscribes no conduct as unlawful and if the legislative history does not speak to the issue of private remedies. The question is exclusively one of statutory construction.

Redington arose out of events preceding the liquidation of Weis Securities, Inc., a member of the New York Stock Exchange, pursuant to the provisions of the Securities Investor Protection Act of 1970. The Securities Investor Protection Corporation (SIPC)³¹ and the court-appointed SIPC trustee each sued the accounting firm, Touche Ross & Co., for improperly auditing and certifying the

19 430 U.S. 1 (1977).

20 15 U.S.C. § 78n(e) (1976).

21 17 C.F.R. § 240.10b-5 (1976).

22 430 U.S. at 24.

23 *Id.* at 41.

24 430 U.S. 462 (1977).

25 17 C.F.R. § 240.10b-5 (1976).

26 15 U.S.C. § 78b (1976).

27 430 U.S. at 477.

28 442 U.S. 560 (1979).

29 430 U.S. 1 (1977).

30 430 U.S. 462 (1977).

31 15 U.S.C. §§ 78aaa-lll (1976 & Supp. 1978).

1972 Weis financial statements and for improperly preparing answers to the Exchange's financial questionnaire. The complaint asserted that such conduct violated section 17(a) of the Exchange Act, which requires brokers and dealers to maintain certain records subject to examination by the SEC "as necessary or appropriate in the public interest, for the protection of investors" ³²

The Court rejected SIPC's argument that tort principles sanction the implication of a private right of action under section 17(a). Writing for the majority, Justice Rehnquist noted that such reasoning was "entirely misplaced" ³³ since "the fact that a federal statute has been violated and some person harmed does not automatically give rise to a private cause of action in favor of that person." ³⁴ Emphasizing that the existence of a statutory right of action is solely a matter of statutory construction, ³⁵ the Court turned to the statutory language to determine congressional intent. Finding section 17(a) did not expressly create a private right of action in favor of anyone, the Court then examined the legislative history. Since the legislative history was also silent regarding a private right of action, the Court refused to infer such a remedy from the absence of any explicit congressional statement denying it. The Court emphasized:

[I]mplying a private right of action on the basis of congressional silence is a hazardous enterprise, at best. And where, as here, the plain language of the provision weighs against implication of a private remedy, the fact that there is no suggestion whatsoever in the legislative history that § 17(a) may give rise to suits for damages reinforces our decision not to find such a right of action implicit within the section. ³⁶

The Court further supported its conclusion by noting that express private rights of action are granted in section 9(e) (prohibition against manipulation of security prices); ³⁷ section 16(b) (prohibition against purchase and sale, or sale and purchase, of any equity security of an issuer within a six-month period by any 10% equity security owner, officer, or director); ³⁸ and section 18(a) (liability for misleading statements in SEC filings). ³⁹ "Obviously, then, when Congress wished to provide a private damages remedy, it knew how to do so and did so expressly." ⁴⁰

The Court addressed four other SIPC arguments particularly relevant to the existence of an implied private right of action under section 6. First, SIPC contended that implication of a private remedy was necessary to effectuate the purpose of the section and was properly a matter of federal concern. According to the Court, however, "such inquiries have little relevance."

The central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action. Indeed, the first three factors discussed in *Cort*—the language and focus of the statute, its legislative history, and its purpose—are ones traditionally relied upon in determining legislative intent. Here, the statute by its terms grants no private rights to any identifiable class and proscribes no con-

32 15 U.S.C. § 78q(a) (1976).

33 442 U.S. at 569 (quoting 15 U.S.C. § 78q(a) (1970)).

34 *Id.* at 568 (quoting *Cannon v. University of Chicago*, 441 U.S. 677, 688 (1979) (Powell, J., dissenting)).

35 442 U.S. at 568.

36 *Id.* at 571 (citations omitted).

37 15 U.S.C. § 78i(e) (1976).

38 15 U.S.C. § 78p(b) (1976).

39 15 U.S.C. § 78r(a) (1976).

40 442 U.S. at 572.

duct as unlawful. And the parties as well as the Court of Appeals agree that the legislative history of the 1934 Act simply does not speak to the issue of private remedies under § 17(a). At least in such a case as this, the inquiry ends there: The question whether Congress, either expressly or by implication, intended to create a private right of action, has been definitely answered in the negative.⁴¹

Second, SIPC argued that *J.I. Case Co. v. Borak*⁴² required implication of a private right of action. The Court found *Borak*'s invocation of the "remedial purposes" of the Exchange Act unavailing:

To the extent our analysis in today's decision differs from that of the Court in *Borak*, it suffices to say that in a series of cases since *Borak* we have adhered to a stricter standard for the implication of private causes of action, and we follow that stricter standard today The ultimate question is one of congressional intent, not one of whether the Court thinks that it can improve upon the statutory scheme that Congress enacted into law.⁴³

The Court also rejected SIPC's arguments that either section 27 of the Exchange Act,⁴⁴ which grants jurisdiction to the federal courts, or the rules adopted under section 17(a)⁴⁵ can themselves imply a damage remedy even if section 17(a) itself does not. It is the substantive provisions of the Exchange Act that control, not the jurisdictional provision or the rules.

Thus, *Redington* establishes that: (1) principles of statutory construction are to be used exclusively in determining the existence of a statutory right of action; (2) in construing a statute, a court must examine express statutory language, legislative history, and the general statutory scheme or framework to ascertain congressional intent; and (3) no private right of action may be implied without a showing of affirmative legislative intent.⁴⁶ *Redington* reflects the Court's committed effort to brake the trend whereby private rights of action are judicially implied despite statutory silence. Fifteen of the Supreme Court's eighteen most recent decisions involving federal securities law have reversed expansive interpretations of federal securities law by the lower courts while three decisions have affirmed lower courts' restrictive interpretations.⁴⁷

41 442 U.S. at 575-76 (citations omitted).

42 377 U.S. 426 (1964).

43 442 U.S. at 578.

44 15 U.S.C. § 78aa (1976).

45 15 U.S.C. § 78q(a) (1976).

46 442 U.S. at 577-78 & n.18.

47 In this regard, see *Aaron v. SEC*, 446 U.S. 680 (1980), *rev'd* 605 F.2d 612 (2d Cir. 1979) (SEC is required to establish scienter to enjoin violations of § 10(b) of the 1934 Act, rule 10b-5, and § 17(a)(1) of the 1933 Act, but is not required to establish scienter to enjoin violations of §§ 17(a)(2) and 17(a)(3) of the 1933 Act); *Chiarella v. United States*, 445 U.S. 222 (1980), *rev'd* 588 F.2d 1358 (2d Cir. 1978) (a person who learns from the confidential documents of one corporation that it is planning a takeover of a second corporation has no duty under Exchange Act § 10(b) or rule 10b-5 to disclose the impending takeover before trading in the target company's securities); *Transamerica Mtg. Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979), *rev'd in part, aff'd in part*, *Lewis v. Transamerica Corp.* 575 F.2d 237 (9th Cir. 1978) (there is no implied private right of action for damages under Investment Advisors Act § 206, and only a limited private right of action for certain equitable relief under Investment Advisors Act § 215); *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979), *rev'd* 592 F.2d 617 (2d Cir. 1978) (there is no implied private right of action for damages under Exchange Act § 17(a)); *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551 (1979), *rev'd* 561 F.2d 1223 (7th Cir. 1977) (the Securities Act and the Exchange Act do not apply to noncontributory, compulsory pension plans); *Coopers & Lybrand v. Livesay*, 437 U.S. 463 (1978), *rev'd* *Livesay v. Punta Gorda Isles, Inc.*, 550 F.2d 1106 (8th Cir. 1977) (federal courts lack appellate jurisdiction to entertain interlocutory appeals from denial of class action certification); *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340 (1978), *rev'd* *Sanders v. Levy*, 558 F.2d 636 (2d Cir. 1976) (absent special circumstances, plaintiffs in a securities fraud class action must bear the expense of identifying class members);

Consistent with *Redington*, the Supreme Court recently refused to imply a private right of action for damages under section 206 of the Investment Advisers Act of 1940,⁴⁸ a provision analogous to section 10(b) of the Exchange Act.⁴⁹ In *Transamerica Mortgage Advisors, Inc. v. Lewis*,⁵⁰ the Court stated that Congressional intent is "dispositive."⁵¹ Since section 206 neither proscribed certain conduct nor, by its terms, created or altered any civil liabilities, the Court refused to "read into the Act" a remedy not expressly provided for by the draftsmen.⁵²

II. *Baird v. Franklin*—The Tort Theory Re-examined

As noted previously, *Baird v. Franklin*⁵³ provides judicial authority for implying a private right of action under section 6 for an exchange's breach of duty. The recent Supreme Court decisions discussed above limiting the implication of a private right of action under section 6 warrant *Baird's* reconsideration.

Baird involved a suit by a customer against the New York Stock Exchange arising from a member broker's embezzlement.⁵⁴ Although the district court had

SEC v. Sloan, 436 U.S. 103 (1978), *aff'd* 547 F.2d 152 (2d Cir. 1976) (SEC lacks authority under Exchange Act § 12(k), based upon a single set of circumstances, to issue a series of summary orders suspending trading in a stock for more than an initial 10-day period); Santa Fe Indus. v. Green, 430 U.S. 462 (1977), *rev'd* 533 F.2d 1283 (2d Cir. 1976) (no implied private right of action for damages under Exchange Act § 10(b) or rule 10b-5 for alleged breach of fiduciary duties in connection with short-form merger may be brought absent allegations of manipulation or deception); Piper v. Chris-Craft Indus., 430 U.S. 1 (1977), *rev'd* 516 F.2d 172 (2d Cir. 1975) (no implied private right of action for damages for a tender offeror suing in its capacity as a takeover bidder under Exchange Act § 14(e)); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976), *rev'd* 512 F.2d 324 (7th Cir. 1975) (in an action under Exchange Act § 14(a), standard of materiality contemplates a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the reasonable shareholder's deliberations); Radzawow v. Touche Ross & Co., 426 U.S. 148 (1976), *aff'd* 516 F.2d 896 (2d Cir. 1975) (national banks can be sued only in the district in which they are established, as required by 12 U.S.C. § 94, notwithstanding the more liberal venue provision of Exchange Act § 27); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), *rev'd* 503 F.2d 1100 (7th Cir. 1974) (maintenance of private right of action for damages under Exchange Act § 10(b) and rule 10b-5 requires an allegation of "scienter," i.e., intent to deceive, manipulate or defraud); Foremost-McKesson, Inc. v. Provident Sec. Co., 423 U.S. 232 (1976), *aff'd* 506 F.2d 601 (9th Cir. 1974) (in a purchase-sale sequence, a beneficial owner must account for profits under Exchange Act § 16(b) only if he was a beneficial owner "before the purchase"); Rondeau v. Mosinee Paper Corp., 422 U.S. 49 (1975), *rev'd* 500 F.2d 1011 (7th Cir. 1974) (persons who may obtain injunctive relief under Exchange Act § 13(d) are limited to those who can show "irreparable harm"); United Hous. Found., Inc. v. Forman, 421 U.S. 837 (1975), *rev'd* Forman v. Community Servs. Inc., 500 F.2d 1246 (2d Cir. 1974) (purchases of cooperative apartment stock were not purchases of "securities" within the purview of the federal securities laws); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), *rev'd* 492 F.2d 136 (9th Cir. 1973) (persons who may maintain a private right of action under rule 10b-5 for money damages are limited to actual purchasers and sellers of securities); Securities Investor Protection Corp. v. Barbour, 421 U.S. 412 (1975), *rev'd* SEC v. Guaranty Bond & Sec. Corp., 496 F.2d 145 (6th Cir. 1974) (no implied private right of action for customers of defunct brokerage firm exists under Securities Investor Protection Act to compel SIPC to exercise its statutory authority for their benefit).

48 15 U.S.C. § 80b-6 (1976).

49 15 U.S.C. § 78j(b) (1976).

50 444 U.S. 11 (1979).

51 *Id.* at 24.

52 *Id.* at 19-20.

53 141 F.2d 238 (2d Cir.), *cert. denied*, 323 U.S. 737 (1944).

54 The factual predicate to the *Baird* decision arises from the scandalous Richard Whitney affair of 1938. Whitney was a former New York Stock Exchange president and senior partner in Richard Whitney & Co., a member firm. While serving on the Exchange's Governing Committee, Whitney converted cash and securities from the Exchange's Gratuity Fund (which was established, pursuant to the Constitution of the N.Y.S.E., to provide payments to survivors of deceased members) and also converted customers' securities entrusted to his brokerage firm.

The Exchange learned of Whitney's misdealings in the Gratuity Fund in November 1937. However, since Whitney's brother had quickly reimbursed the Fund, the Exchange took no action against Richard Whitney. Indeed, the Exchange failed to investigate or take any disciplinary action against Whitney or his

dismissed the complaint for failure to state a claim,⁵⁵ the court of appeals reversed. The Second Circuit held the New York Stock Exchange "violated a duty when it failed to take [timely] disciplinary action . . . after there was reason to believe that [the broker] had converted . . . plaintiffs' securities."⁵⁶ While dissenting on the issues of burden of proof and causation, Judge Clark articulated the court's reasons for concluding that a private right of action should be implied under section 6.

First, Judge Clark relied on the familiar tort theory: "It is well established that members of a class for whose protection a statutory duty is created may sue for injuries resulting from its breach and that the common law will supply a remedy if the statute gives none."⁵⁷ *Redington* expressly rejects the tort theory in the following terms: "[T]he fact that a federal statute has been violated and some person harmed does not automatically give rise to a private right of action in favor of that person,"⁵⁸ quoting *Cannon v. University of Chicago*.⁵⁹

Second, Judge Clark spoke of the "necessity" of implying a private remedy. Otherwise, he remarked, the legislation would be little more than "a snare and a delusion."⁶⁰ *Redington* considers the "necessity" argument irrelevant. Implication is solely a question of legislative intent where "the statute by its terms grants no private rights to any identifiable class and proscribes no conduct as unlawful."⁶¹

Third, Judge Clark relied on statutory "purpose." Noting that the Exchange Act contained 37 references to protecting the public,⁶² Judge Clark observed: "[I]f the investing public is to be completely and effectively protected, § 6(b) must be construed as granting to injured investors individual causes of action to enforce the statutory duties imposed upon the exchanges."⁶³ *Redington*, however, rejects the "remedial purpose" argument: "[G]eneralized references to the 'remedial purposes' of the 1934 Act will not justify reading a provision 'more broadly than its language and the statutory scheme reasonably permit.'"⁶⁴ Moreover, the Court expressly declined to read *Borak*⁶⁵ "so broadly that virtually every provision of the securities acts gives rise to an implied private right of ac-

firm until March 1938. By that time, Whitney's embezzlement of his customers' securities exceeded \$200,000. For a discussion of the Whitney affair, see J. BROOKS, *ONCE IN GOLCONDA, A TRUE DRAMA OF WALL STREET 1920-1938*, 230-87 (1969).

55 *Baird v. Franklin* was tried without a jury before Judge Cox, and judgment dismissing the complaint was entered in the office of the Clerk of the Court. Civ. Nos. 42-7-354 and 42-8-295 (S.D.N.Y., Nov. 30, 1942). The Court found that (i) no private right of action could be maintained against an exchange under section 6 of the Exchange Act (First Conclusion of Law) and (ii) "the agreement filed with the S.E.C. by the N.Y.S.E. pursuant to Section 6(a)(1) of the Securities Exchange Act of 1934 does not give to these plaintiffs a right of action for any breach thereof" (Second Conclusion of Law).

56 141 F.2d at 238. Decisions subsequent to *Baird* have shown that knowledge is not a prerequisite to maintenance of a section 6 action against a national securities exchange. Rather, the section 6 action is negligence-based. See, e.g., *Hughes v. Dempsey-Tegeler & Co.*, 534 F.2d 156 (9th Cir.), cert. denied, 429 U.S. 896 (1976) (New York Stock Exchange); *Hochfelder v. Midwest Stock Exch.*, 503 F.2d 364 (7th Cir.), cert. denied, 419 U.S. 875 (1974); *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963).

57 141 F.2d at 245.

58 442 U.S. at 568.

59 441 U.S. 677, 688 (1979).

60 141 F.2d at 245.

61 442 U.S. at 576.

62 141 F.2d at 244 & n.4.

63 *Id.* at 244-45.

64 442 U.S. at 578.

65 *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964).

tion."⁶⁶

Fourth, Judge Clark did not consider himself bound by the established principle of statutory construction "expressio unius est exclusio alterius."⁶⁷ *Redington* adheres to this maxim. As the Court explained, "when Congress wished to provide a private damage remedy [under the Exchange Act], it knew how to do so and did so expressly."⁶⁸

Fifth, Judge Clark did not examine statutory language or history for positive indications of legislative intent. Indeed, subsequent cases citing *Baird* regarded such an inquiry as unnecessary.⁶⁹ As stated by one court, "[m]ere silence is not decisive."⁷⁰ *Redington* holds that legislative intent is the fundamental basis upon which a private right of action may be implied.⁷¹ The Exchange Act's silence should be determinative of the implication question.

In short, the *Baird* rationale has been discredited by *Redington*. Applying the *Redington* standards to section 6 demonstrates that no private right of action against an exchange should be implied in favor of public investors.

A. Statutory Language and Legislative History

Redington requires a court to begin its analysis by examining the statutory language. Section 6(a) of the Exchange Act⁷² prescribes the terms for registration as a national securities exchange. Section 6(b)⁷³ requires an exchange "to enforce compliance by its members and persons associated with its members" with the provisions of the Exchange Act, SEC rules and regulations, and the rules of the exchange itself. Section 6(b) also requires an exchange to formulate and enforce rules to promote just and equitable principles of trade. Section 6(d)⁷⁴ sets forth the procedural standards to be utilized by an exchange in disciplining members.

The language of section 6 makes no reference to any private right of action

⁶⁶ 442 U.S. at 577.

⁶⁷ 141 F.2d at 245. In this regard Judge Clark wrote:

Nor is there any validity to defendant's objection that, since §§ 9(c), 16(b), and 18(a), 15 U.S.C.A. §§ 78i(c), 78p(b), 78r(a), grant specific rights of action in certain circumstances, the maxim "expressio unius est exclusio alterius" denies the implied right of action under § 6(b). Those three sections deal with special matters only indirectly germane to the regulation of securities exchanges; they provide for more unrestricted recovery than would be possible at common law; and they prescribe narrow statutes of limitation. Also § 28(a), 15 U.S.C.A. § 78bb(a), directly states that "the rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity." As the Supreme Court has very lately said: "Some rules of statutory construction come down to us from sources that were hostile toward the legislative process itself and thought it generally wise to restrict the operation of an act to its narrowest permissible compass. However well these rules may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy."

Id. (quoting *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350 (1943)).

⁶⁸ 442 U.S. at 572.

⁶⁹ See, e.g., *Brown v. Bullock*, 194 F. Supp. 207, 224-25 (S.D.N.Y.), *aff'd*, 294 F.2d 415 (2d Cir. 1961): "Implied rights of action are not contingent upon statutory language which affirmatively indicates that they are intended. On the contrary, they are implied unless the legislation evidences a contrary intention."

⁷⁰ See *Fagot v. Flintkote Co.*, 305 F. Supp. 407, 412 (E.D. La. 1969).

⁷¹ 442 U.S. at 568.

⁷² 15 U.S.C. § 78f(a) (1976).

⁷³ 15 U.S.C. § 78f(b) (1976).

⁷⁴ 15 U.S.C. § 78f(d) (1976).

against an exchange. The statute merely sets forth the necessary preconditions for registering an exchange (section 6(a))⁷⁵ and contains a provision (section 6(b)),⁷⁶ phrased negatively, requiring the rules of an exchange to contain certain provisions. Unlike prohibitory statutes such as section 10(b)⁷⁷ or 14⁷⁸ of the Exchange Act, section 6 does not declare any exchange conduct unlawful.

The legislative history of section 6 also fails to disclose any evidence Congress intended, or even considered, granting a private right of action against an exchange.⁷⁹ Rather, debate centered on the extent of rulemaking and enforce-

75 The text of § 6(a), 15 U.S.C. § 78f(a) (1976), reads as follows:

(a) An exchange may be registered as a national securities exchange under the terms and conditions hereinafter provided in this section and in accordance with the provisions of section 78s(a) of this title, by filing with the Commission an application for registration in such form as the Commission, by rule, may prescribe containing the rules of the exchange and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

76 Section 6(b), 15 U.S.C. § 78f(b) (1976), provides:

(b) An exchange shall not be registered as a national securities exchange unless the Commission determines that—

(1) Such exchange is so organized and has the capacity to be able to carry out the purposes of this chapter and to comply, and (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) to enforce compliance by its members and persons associated with its members, with the provisions of this chapter, the rules and regulations thereunder, and the rules of the exchange.

(2) Subject to the provisions of subsection (c) of this section, the rules of the exchange provide that any registered broker or dealer or natural person associated with a registered broker or dealer may become a member of such exchange and any person may become associated with a member thereof.

(3) The rules of the exchange assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer.

(4) The rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

(5) The rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange.

(6) The rules of the exchange provide that (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) its members and persons associated with its members shall be appropriately disciplined for violation of the provisions of this chapter, the rules or regulations thereunder, or the rules of the exchange, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

(7) The rules of the exchange are in accordance with the provisions of subsection (d) of this section, and, in general, provide a fair procedure for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the exchange of any person with respect to access to services offered by the exchange or a member thereof.

(8) The rules of the exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

77 15 U.S.C. § 78j(b) (1976).

78 15 U.S.C. § 78n (1976).

79 See Note, *Exchange Liability under Section 6 of the Securities Exchange Act: The Eligible Plaintiff Problem*, 78 COLUM. L. REV. 112, 126 (1978). An excellent historical discussion of congressional attempts to enact federal securities legislation prior to 1933 is presented in Lippman, *The Securities Exchange Act of 1934 and the Commerce Clause*, 69 U.S. L. REV. 19 (1935).

ment authority to be given a governmental regulatory agency vis-a-vis exchanges and state agencies.⁸⁰

Committee reports, legislative debates, congressional hearings, statements of the draftsmen, comments of interested parties, and contemporaneous law review articles indicate no intention to afford public investors a right of action against an exchange.⁸¹ Nor is there any dispositive statement regarding private rights of action under section 6 in the legislative history surrounding passage of the Securities Acts Amendments of 1975.⁸²

B. *The SEC's Exclusive Authority to Monitor Exchanges*

Prior to passage of the Exchange Act in 1934,⁸³ stock exchanges were considered private clubs.⁸⁴ Organized as voluntary unincorporated associations, exchanges received virtually no governmental or judicial oversight.⁸⁵ What little judicial oversight there was merely focused on ensuring that exchangers adopted and followed procedures conforming with the organization's constitution and by-laws. The constitution and by-laws were considered a "contract by which each member had consented to be bound, and which measure[d] his duties, rights and

⁸⁰ See, e.g., *Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 20, 22 (statement of Mr. Landis), 199, 226-27 (statement of Mr. Whitney), 502 (letter from Mr. Allen), 669-770 (memorandum of Mr. Johnson) (1934); *Stock Exchange Practices: Hearings on S. Res. 84, S. Res. 56 and S. Res. 97 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 6566-76 (statement of Mr. Corcoran), 6625-26, 6638-39 (statement of Mr. Whitney), 6903-04 (statement of Mr. Hope), 6926 (statement of Mr. Legg), 6938 (statement of Mr. Bernheim), 7143 (memorandum of Mr. Wetsel), 7569-72 (statement of Mr. Redmond) (1934).

⁸¹ See generally Note, *Implied Civil Liability Under the Securities Exchange Act*, 61 HARV. L. REV. 858, 860 (1948).

⁸² Pub. L. No. 94-29, 89 Stat. 137 (1975). The only reference to private rights of action in the legislative reports to the Securities Acts Amendments of 1975 occurs regarding the promulgation of section 21(h), 15 U.S.C. § 78w(h) (1976), which exempts SEC enforcement actions from pre-trial consolidation under 28 U.S.C. § 1407. The Commission requested this exemption realizing that

although both the Commission's suit for injunctive relief brought pursuant to express statutory authority and a private action for damages fall within the general category of civil (as distinct from criminal) proceedings, their objectives are really very different. Private actions for damages seek to adjudicate a private controversy between citizens; the Commission's action for civil injunction is a vital part of the Congressionally mandated scheme of law enforcement in the securities area.

S. REP. NO. 75, 94th Cong., 1st Sess. 76, reprinted in [1975] U.S. CODE CONG. & AD. NEWS 179, 254.

It can be argued that this reference to private rights of action constitutes an implicit approval or recognition by Congress of the holding of *Baird v. Franklin* and its progeny. As stated by Judge Friendly, "when a principle has become settled through court decisions, there is no occasion for Congress to speak unless it wishes a change." Leist v. Simplot, 2 COMM. FUT. L. REP. (CCH) ¶ 21051 (2d Cir. 1980). On the other hand, it can be argued that such a fleeting reference is not significant, or, alternatively, that the reference to private actions "between citizens" indicates that Congress was not focusing on private suits against quasi-administrative bodies such as national securities exchanges. The Supreme Court has pointed out that the "search for significance in the silence of Congress is too often the pursuit of a mirage." *Scripps-Howard Radio, Inc. v. FCC*, 316 U.S. 4, 11 (1942) (Frankfurter, J.). See generally *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 204 n.24 (1975). Any leap to congressional approval should be made very cautiously, if at all.

It is the author's position that the 1975 amendments do not provide any meaningful basis upon which to hold (or infer) that Congress approved of the implication of a private right of action under § 6 or acquiesced to *Baird* and its progeny. These amendments merely reflect Congress's continuing silence on the matter.

⁸³ 15 U.S.C. § 78a-kk (1976 & Supp. 1978).

⁸⁴ See, e.g., *Belton v. Hatch*, 109 N.Y. 593, 17 N.E. 225 (1888) (New York Stock Exchange). See also *Silver v. New York Stock Exch.*, 373 U.S. 341, 350-51 (1963). See generally Note, *supra* note 79, at 113 n.7.

⁸⁵ See Jennings, *Self-Regulation in the Securities Industry: The Role of the Securities and Exchange Commission*, 29 LAW & CONTEMP. PROB. 663, 663 n.2, 667 (1964).

privileges."⁸⁶

In 1913, the Pujo Committee recommended that the New York Stock Exchange be required to incorporate and submit to federal regulation.⁸⁷ However, the Exchange's position against legislative or judicial intervention prevailed. In the aftermath of the 1929 stock market crash and subsequent congressional discovery of exchange wrongdoing,⁸⁸ debate shifted from whether or not there should be outside regulation or supervision of exchanges to how much government involvement there should be with exchanges. Recognizing that "if governmental regulation attempts to do too much directly and to control and intervene directly in the first instance over the whole field which it covers, it is in danger of breaking down under its own weight and proving ineffective,"⁸⁹ Congress struck a compromise and afforded the exchanges a large measure of self-regulation. As then SEC Chairman William O. Douglas explained:

From the broad public viewpoint, such regulation can be far more effective [than direct regulation]. . . . Self-regulation . . . can be pervasive and subtle in its conditioning influence over business practices and business morality. By and large, government can operate satisfactorily only by proscription. That leaves untouched large areas of conduct and activity; some of it susceptible of government regulation but in fact too minute for satisfactory control; some of it lying beyond the periphery of the law in the realm of ethics and morality. Into these large areas self-government, and self-government alone, can effectively reach. For these reasons such self-regulation is by far the preferable course from all viewpoints.⁹⁰

The structure of the Exchange Act reflects congressional adherence to the principle of exchange self-regulation. Thus, when read together, sections 6,⁹¹ 19⁹² and 25⁹³ of the Exchange Act constitute a self-contained, unified framework for SEC control of securities exchanges.⁹⁴ Section 6 establishes the conditions for

86 *Belton v. Hatch*, 109 N.Y. 593, 596, 17 N.E. 225, 226 (1888). See, e.g., *White v. Brownell*, 2 Daly 329, 4 Abb. Pr. 162 (C.P.N.Y. 1868) (organization of stock brokers).

87 See *Hearings before the Subcomm. of the House Comm. on Banking and Currency on Investigation of Financial and Monetary Conditions in the United States under House Resolutions Nos. 429 and 504*, 62 Cong., 2d Sess. 115 (1913). Earlier, the Hughes Commission had rejected the suggestion that the New York Stock Exchange be incorporated and placed more directly under the aegis of the state and the courts. See ANTWERP, *THE STOCK EXCHANGE FROM WITHIN* 415-16 (1913), cited in Jennings, *supra* note 85, at 668 & n.31.

88 See, e.g., *Hearings before the Senate Comm. on Banking and Currency on Stock Exchange Practices*, 73d Cong., 1st Sess. (1933).

89 *Stock Exchange Regulation: Hearings on H.R. 7852 and 8720 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 513 (1934).

90 Address by SEC Chairman Douglas before the Bond Club of Hartford, Conn. (Jan. 7, 1938) (cited in Jennings, *supra* note 85, at 678).

91 15 U.S.C. § 78f (1976).

92 15 U.S.C. § 78s (1976 & Supp. 1978).

93 15 U.S.C. § 78y (1976).

94 See generally VERNON, *THE REGULATION OF STOCK EXCHANGE MEMBERS* (1941). Dr. Vernon, a senior financial statistician with the SEC, articulated two guiding principles for the regulation of the securities marketplace—that the market be fair and that it be orderly. He wrote:

A 'fair' market bears the connotation of a market in which the individual investor need not fear for the integrity of his broker, the safety of his funds, or the possibility that price movements are being artificially controlled. An 'orderly' market is regarded as one in which there are no 'sudden and unreasonable fluctuations in the prices of securities' and consequently a market which makes no unnecessary adverse contribution to the stability and well-being of the public at large. The two major functions of regulation, therefore, are carefully distinguished: the goal of fairness, directed primarily at the protection of the individual, may be looked upon as something in the nature of a police function, while the 'orderly market' aim, an aim intended to benefit the general public interest, is more suggestive of the use by Government of economic controls.

exchange registration. Prior to granting an application for registration, the SEC, pursuant to section 6(b),⁹⁵ must find that an exchange is "able to carry out" the purposes of the Exchange Act and that its rules "in general protect investors and the public interest."

In section 19(a) of the Exchange Act,⁹⁶ the SEC is empowered to require registered exchanges to discharge their self-regulatory responsibilities. Section 19(h)(1)⁹⁷ authorizes the SEC to discipline an exchange for violating the Exchange Act or any rules thereunder, or for failing to enforce compliance therewith by a member or a person associated with a member. Pursuant to section 19, the SEC has withdrawn the registration of a national securities exchange for failure to enforce compliance with the Exchange Act and the exchange's rules.⁹⁸ That disciplinary proceeding was reviewed and affirmed under the Exchange Act.⁹⁹

Congress also granted the SEC jurisdiction to supervise the nature and structure of exchanges. Under section 19(c), by rule the SEC "may abrogate, add to, and delete from the rules of a self-regulatory organization . . . as the Commission deems necessary or appropriate to ensure the fair administration of the self-regulatory organization."¹⁰⁰

An SEC order may be reviewed by a federal court of appeals under section 25 of the Act.¹⁰¹ That section provides the exclusive method for judicial review of SEC orders.¹⁰² Section 25(a)(4) specifically recognizes the SEC's expertise by providing that SEC findings of fact are conclusive if supported by substantial evidence.¹⁰³

Exchange self-regulation was reaffirmed in the Securities Acts Amendments of 1975.¹⁰⁴ Although the total regulatory fabric needed strengthening, Congress concluded that self-regulation had worked well and should be preserved.¹⁰⁵ The amendments were designed to achieve these purposes "not only by clarifying reg-

Id. at 132. *Accord*, SEC, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. DOC. NO. 95, 88th Cong., 1st Sess., 13-15 (1963).

⁹⁵ 15 U.S.C. § 78f(b) (1976).

⁹⁶ 15 U.S.C. § 78s(a) (1976).

⁹⁷ 15 U.S.C. § 78s(h)(1) (1976).

⁹⁸ 15 U.S.C. § 78s(a)(3) (1976).

⁹⁹ *See In re San Francisco Mining Exch.*, SEC Exchange Act Release No. 7870, [1964-66 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77,343, *enforced sub nom.* *San Francisco Mining Exch. v. SEC*, 378 F.2d 162 (9th Cir. 1967) (noting exchange's "pervasive and abysmal abdication of responsibility"). The SEC's power to discipline national securities exchanges recently was exercised in *In re Philadelphia Stock Exch.*, Exchange Act Release No. 16,648, [Current] FED. SEC. L. REP. (CCH) ¶ 82,475. In this administrative proceeding pursuant to Exchange Act § 19(h), the SEC charged the Philadelphia Stock Exchange with violations of Exchange Act §§ 11A(c)(1) and 19(g) and rule 11Ac1-1 promulgated thereunder. The proceeding was settled by entry of a consent order in which the Philadelphia Stock Exchange represented that "it has made and has undertaken to make, extensive revisions in organizational structure, personnel, commitment of resources, programs, policies and procedures designed to strengthen its market surveillance and enforcement capabilities." *Id.* ¶ 82,999. The SEC also censured the exchange.

¹⁰⁰ 15 U.S.C. § 78s(b) (1976 & Supp. 1978).

¹⁰¹ 15 U.S.C. § 78y (1976).

¹⁰² *See, e.g.*, *SEC v. Andrews*, 88 F.2d 441, 442 (2d Cir. 1937); *American Sumatra Tobacco Corp. v. SEC*, 93 F.2d 236, 241 (D.C. Cir. 1937); *Sutro Bros. & Co. v. SEC*, 199 F. Supp. 438, 439 (S.D.N.Y. 1961).

¹⁰³ *See, e.g.*, *Exchange Buffet Corp. v. New York Stock Exch.*, 244 F.2d 507 (2d Cir. 1957); *Atlas Tack Corp. v. New York Stock Exch.*, 246 F.2d 311 (1st Cir. 1957); *Shawmut Ass'n v. SEC*, 146 F.2d 791 (1st Cir. 1945).

¹⁰⁴ Pub. L. No. 94-29, 89 Stat. 137 (1975).

¹⁰⁵ S. REP. NO. 75, 94th Cong., 1st Sess. 23, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179, 201-02. The Senate bill (S. 249) was passed in lieu of the House bill (H.R. 4111).

ulatory responsibilities at all levels but also by assuring that the self-regulatory organizations follow effective and fair procedures, that their activities are not anticompetitive and that the Commission's oversight powers are ample and its responsibility to correct self-regulatory lapses is unmistakable."¹⁰⁶ The Senate Committee on Banking, Housing and Urban Affairs observed that

[t]o the degree that there may have been undue deference to the self-regulatory organizations because of the cumbersomeness of the oversight mechanisms or the unavailability of appropriately focused remedies, the Committee believes the Exchange Act should be amended to correct the problem. However, the Committee also believes that the successful performance of the Commission's oversight task necessarily involves [its] willingness to take steps to assure that the self-regulatory agencies comply with and advance the policies of the Exchange Act.¹⁰⁷

. . . .

The Committee expects the additional enforcement powers provided by the bill to lead to an increased willingness on the part of the Commission to take formal action when needed to assure adequate self-regulatory performance. Although the Congress cannot mandate such a willingness, the Committee has no reason to believe that the Commission . . . would not be responsive to such an explicit expression of congressional intent.¹⁰⁸

Thus, the Exchange Act's legislative history demonstrates that the SEC, expressly entrusted with the national public interest by sections 2 and 4 of the Exchange Act, was granted the power and responsibility for overseeing the conduct of registered exchanges. As the House Report states, "[a]lthough a wide measure of initiative and responsibility is left with the exchanges, reserved control is in the

¹⁰⁶ *Id.* "In the new regulatory environment created by the bill, self-regulation would be continued, but the SEC would be expected to play a much larger role than it has in the past to ensure that there is no gap between self-regulatory performance and regulatory need" *Id.* at 2, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179, 181.

¹⁰⁷ *Id.* at 34, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179, 212.

¹⁰⁸ *Id.* at 35, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179, 213. Principal amendments to the Exchange Act, designed to strengthen the SEC's oversight powers (especially with respect to review and enforcement of exchange rules) are contained in § 19, 15 U.S.C. § 78s (1976 & Supp. 1978), and § 21, 15 U.S.C. § 78w (1976). In § 19(h)(1), 15 U.S.C. § 78s(h)(1) (1976), the SEC, in addition to its power to suspend and deregister a self-regulatory agency, is given the power to censure and place restrictions on the activities, functions and operations of the self-regulatory agency. The Commission is directed to take action against any self-regulatory organization upon a finding that the organization has failed to enforce its own rules, SEC rules, or any applicable provisions of the Exchange Act. Section 19(h)(4), 15 U.S.C. § 78s(h)(4) (1976), authorizes the Commission to censure or remove from office any officer or director of a self-regulatory organization who *willfully* fails to enforce compliance with such rules or Exchange Act provisions.

Sections 21(e) and 21(f) of the Act, 15 U.S.C. §§ 78w(e)-(f) (1976), were strengthened to enable the SEC to apply to the federal courts for an order enjoining the violation of the rules of a self-regulatory organization. Jurisdiction of the district courts was concomitantly expanded to enable the courts, upon application by the SEC, to command (1) a member or participant in a self-regulatory organization to comply with, and (2) a self-regulatory organization to enforce compliance by its members and persons associated with its members with the Exchange Act and Commission and exchange rules. As noted in the Senate Report, "in the unlikely event that a self-regulatory organization is not enforcing the Exchange Act or its own rules in an appropriate manner, the SEC should have no reluctance to utilize the courts to compel the organization to do so."

S. REP. NO. 75, 94th Cong., 1st Sess. 135, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 179, 312.

Section 25, 15 U.S.C. § 78y (1976), dealing with judicial review, was also revised to provide for review of SEC rules (including those approving and disapproving self-regulatory actions) as well as SEC orders.

These statutory changes, which typify the thrust of the Securities Act Amendments of 1975, provide the clearest example yet of Congress's intent to continue the principle of exchange self-regulation within the existing statutory framework. Whether the 1975 amendments were intended to supplant *Baird* or supplement *Baird*, however, is a matter open to speculation.

Commission if the exchanges do not meet their responsibility.”¹⁰⁹ Likewise, the Senate Report states that “it is essential to entrust the administration of the act to an agency vested with power to eliminate undue hardship and to prevent and punish evasion.”¹¹⁰ In a letter to Congress, President Roosevelt pointed out that “the Government should be given such definite powers of supervision over exchanges that the Government itself will be able to correct abuses which may arise in the future.”¹¹¹ The Supreme Court has noted that supervised self-regulation, although consonant with the traditional private governance of exchanges, allows the government to monitor exchange business in the public interest.¹¹²

Consistent with the foregoing authority, a court should not imply a private right of action against an exchange under section 6. The Exchange Act contemplates that the SEC alone is empowered to sue for an injunction or for mandamus, or to censure, suspend or expel an exchange for statutory violations, subject to appellate review. This conclusion is borne out by a 1973 legislative study dealing with the securities industry’s performance.¹¹³ After a thorough review of the Exchange Act’s operation since its inception, the study observed that “[n]o provision of the Exchange Act confers jurisdiction upon the courts to directly review the self-regulatory activities of national securities associations.”¹¹⁴ Rather, “Commission oversight is the catalyst which creates jurisdiction in the courts to review exchange . . . decisions.”¹¹⁵ Although sections 6, 19 and 25 were amended in 1975,¹¹⁶ no changes were made in the statutory language which would authorize private remedies.

Except where private rights of action are specifically enunciated, the entire scheme of the Exchange Act reflects a determination that the statutory mandate will be achieved through the SEC’s efforts.¹¹⁷ The conclusion that the SEC alone is empowered to take action against an exchange under section 6 follows from *National Railroad Passenger Corp. v. National Association of Railroad Passengers*.¹¹⁸ In that case the Rail Passenger Service Act of 1970 (Amtrak Act)¹¹⁹ provided an express remedy giving the Attorney General the right to institute a civil action. The Court held that the express provision of a remedy to the Attorney General precluded inferring a civil action in favor of the plaintiffs. Similarly, in *Transamerica Mortgage Advisors, Inc. v. Lewis*,¹²⁰ the Court recognized the impropriety of implying a private right of action from a statutory provision whose enforcement had been left to the SEC. The mere fact the statute was designed to protect investors was not dispositive and did not require judicial implication of addi-

109 H.R. REP. NO. 1383, 73d Cong., 2d Sess. 15 (1934).

110 S. REP. NO. 792, 73d Cong., 2d Sess. 5 (1934).

111 H.R. REP. NO. 1383, 73d Cong., 2d Sess. 2 (1934); S. REP. NO. 792, 73d Cong., 2d Sess. 2 (1934).

112 See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 127-28 (1973).

113 SECURITIES INDUSTRY STUDY: REPORT OF THE SEN. SUBCOMM. ON SECURITIES, COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, S. DOC. NO. 13, 93d Cong., 1st Sess. (1973) [hereinafter cited as SECURITIES INDUSTRY STUDY].

114 *Id.* at 210.

115 *Id.* at 214.

116 See Securities Act Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 137 (1975).

117 See generally Redmond, *The Securities Exchange Act of 1934: An Experiment in Administrative Law*, 47 YALE L.J. 622, 624-26 (1938).

118 414 U.S. 453 (1974).

119 45 U.S.C. §§ 501-645 (1970 & Supp. V 1975).

120 444 U.S. 11 (1979).

tional remedies.¹²¹ As stated by the Court:

"When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode." Congress expressly provided both judicial and administrative means for enforcing compliance with § 206 [of the Investment Advisers Act]. First, under § 217 willful violations of the Act are criminal offenses, punishable by fine or imprisonment, or both. Second, § 209 authorizes the Commission to bring civil actions in federal courts to enjoin compliance with the Act, including, of course, § 206. Third, the Commission is authorized by § 203 to impose various administrative sanctions on persons who violate the Act, including § 206. In view of these express provisions for enforcing the duties imposed by § 206, it is highly improbable that "Congress absentmindedly forgot to mention an intended private action."¹²²

This reasoning applies equally to the Exchange Act, a predecessor of the Investment Advisers Act.

III. *Weinberger v. New York Stock Exchange*: The Contract Theory Re-examined

Prior to the Securities Act Amendments of 1975,¹²³ section 6(a)(1) contained a provision requiring an exchange to file an "agreement . . . to comply and enforce so far as is within its powers compliance by its members, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder."¹²⁴ In *Weinberger v. New York Stock Exchange*,¹²⁵ the district court construed the section 6(a)(1) "agreement" between the SEC and an exchange as a contract giving public investors rights as intended third party beneficiaries.¹²⁶ The court then concluded that the plaintiffs' claim "should be

¹²¹ *Id.* at 24.

¹²² *Id.* at 20 (citations omitted).

¹²³ Pub. L. No. 94-29, 89 Stat. 137 (1975).

¹²⁴ 15 U.S.C. § 78f(a)(1) (1934) then provided:

(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this title, and any amendment thereto and any rule or regulation made or to be made thereunder;

As part of its compliance with section 6(a)(1), the Exchange filed with the SEC the "agreement" set forth below.

The New York Stock Exchange hereby agrees, upon the express understanding that such agreement shall not be construed as a waiver of any constitutional right of the Exchange or any member thereof, or of any right of the Exchange or any member thereof to contest the validity of any provision of the Securities Exchange Act of 1934 or of any rule or regulation made pursuant thereto, (a) to comply and to enforce so far as is within its powers compliance by its members with the provisions of Title I of the Securities Exchange Act of 1934 and any amendment thereto and any rule or regulation made or to be made thereunder, and (b) to furnish to the Commission three copies of any amendments to the rules of the Exchange forthwith upon their adoption.

¹²⁵ 335 F. Supp. 139 (S.D.N.Y. 1971). Plaintiff was a former limited partner of Ira Haupt & Co., which had been victimized in the infamous "Salad Oil Swindle." Ira Haupt & Co. had extended multi-million dollar credits to a vegetable oil refining company, receiving as collateral warehouse receipts which proved to be bogus.

¹²⁶ The court relied for its conclusion on RESTATEMENT OF CONTRACTS § 145 (1932), which states: A promisor bound to the United States or to a State or municipality by contract to do an act or render a service to some or all of the members of the public, is subject to no duty under the contract to such members to give compensation for the injurious consequences of performing or attempting to perform it, or of failing to do so, unless,

governed by the statute of limitations applicable to contracts."¹²⁷ Although *Baird* had suggested that public investors might have contractual rights as third party beneficiaries of the agreement filed by an exchange,¹²⁸ *Baird* did not expressly pass upon this issue.¹²⁹

The *Weinberger* decision lacks a solid foundation because the "agreement" required by section 6(a)(1) did not impose any duty or grant any benefits that did not already exist by virtue of the statute. As the court conceded, the only basis for implying that any "contract" was intended to afford third party beneficiary rights is that the statute itself, as interpreted in *Baird*, created a duty for the benefit of public investors.¹³⁰ Moreover, *Weinberger's* conclusion that the agreement required by section 6(a)(1) "achieves a status of its own as a contract"¹³¹ is not supported by the authorities the court relied upon. In each case cited, the contract had independent significance even though it also expressed a duty required by statute.

For example, *Fata v. S.A. Healy Co.*¹³² involved a public works contract in which the defendant had agreed to construct public works for a city. A New York statute required the contract to state that each laborer would be paid wages according to the statute. The plaintiff sued to recover the difference between his pay and the amount specified in the contract. The contract was not entered into merely to require the contractor to pay statutory wages but also to create duties

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- a) an intention is manifested in the contract, as interpreted in the light of the circumstances surrounding its formation, that the promisor shall compensate members of the public for such injurious consequences.

The court found such an intent implicit in the statute and, *a fortiori*, in the contract filed pursuant to the statute. 335 F. Supp. at 143-44. Judge Gurfein discounted the concerns expressed by Judge Cardozo in *H.R. Moch Co. v. Rensselaer Water Co.*, 247 N.Y. 160, 159 N.E. 896 (1928), regarding the disruptive effect of unexpected liability. In this instance, said the court, there would be no unexpected liability since *Baird* had already held that exchanges were liable for breach of its statutory duties. 335 F. Supp. at 144 n.10. See generally Note, *Exchange Liability for Net Capital Enforcement*, 73 COLUM. L. REV. 1262, 1277-78 (1973).

127 335 F. Supp. at 145. Since the Exchange Act provided no statute of limitations period with respect to this contract claim, the court, consistent with *Cope v. Anderson*, 331 U.S. 461 (1947), looked to the appropriate statute of limitations of the forum state (New York). The contract statute of limitations in New York is six years, N.Y. CIV. PRAC. LAW § 213(2) (McKinney 1971), whereas the statute of limitations for violation of a statute is three years, N.Y. CIV. PRAC. LAW § 214(2) (McKinney 1971).

Had the court not adopted the contract rationale, with its longer statute of limitations period, plaintiff's action would have been time-barred. The sympathetic plight of plaintiff may have been a factor in the court's determination. See note 125 *supra*. Still, it seems anomalous for a court to recognize a six year limitation period when an exchange is only required by law to maintain its records for five years. See 17 C.F.R. § 240.17a-1 (1979).

The limitations question raised in *Weinberger* has never been formally reviewed by any federal court of appeals. The issue was certified for appeal and accepted by the Second Circuit in *Lank v. New York Stock Exch.*, 548 F.2d 61 (2d Cir. 1977), but *Lank* was decided on other grounds. See text accompanying notes 8-10 *supra*. In *Wilson v. Meyerson & Co.*, Civ. No. 72-1298 (N.D. Cal. Apr. 7, 1976), the court implicitly rejected the contract statute of limitations in favor of the limitations period for a liability created by statute. The court noted that a liability created by statute exists where the cause of action raised was unknown at common law. At common law, a claim against an exchange for breach of a duty to supervise its members did not exist. See text accompanying notes 84-87 *supra*.

128 See *Baird v. Franklin*, 141 F.2d 238, 244 (2d Cir.), *cert. denied*, 323 U.S. 737 (1944): "Our considered opinion is that the [Exchange] Act itself grants the right of action: hence it is unnecessary to consider the narrower contract problem."

129 Judge Gurfein viewed the contract issue as an apparent matter of first impression, 335 F. Supp. at 142, although Judge Cox, also of the Southern District of New York, previously had rejected the contract contention. See note 55 *supra*.

130 335 F. Supp. at 144.

131 *Id.* at 145.

132 289 N.Y. 401, 46 N.E.2d 339 (1943).

of and benefits for both the contractor and the city regarding the construction project. Also, the contract did not merely recite the obligations in the terms of the statute. The contract contained a detailed agreement to pay wages according to a schedule annexed to the contract. The court held: "The obligation thus assumed by the contractor is precise, and extends beyond the scope of the statutory obligation. The statutory remedy provided for breach of the statutory obligation would be an inadequate and unsuitable remedy for a violation of this contractual obligation."¹³³

Filardo v. Foley Brothers,¹³⁴ another case cited in *Weinberger*, involved a construction contract with the United States government. A federal statute¹³⁵ required the contractor to pay time and one-half for overtime. The construction contract provided the defendant would "obey and abide by all applicable laws . . . of the United States."¹³⁶ The contract had a status independent of the statute since it covered all phases of the construction project. The court held a laborer had an implied right to recover overtime wages from the contractor because such a right effectuated the purpose of the statute and because the laborer was a beneficiary of the construction contract. Similarly, in *United States ex rel. Johnson v. Morley Construction Co.*¹³⁷ and in *Lemon v. Bossier Parish School Board*,¹³⁸ the contracts went beyond a mere recital of a pre-existing statutory duty and imposed burdens and gave benefits unrelated to a statutory duty.¹³⁹

In the case of an exchange, however, an exchange gained no rights, except the right to conduct business, by filing the section 6(a)(1) agreement in its registration statement.¹⁴⁰ To hold otherwise would exalt form over substance.¹⁴¹

¹³³ 289 N.Y. at 406-07, 46 N.E.2d at 341-42.

¹³⁴ 297 N.Y. 217, 78 N.E.2d 480 (1948), *rev'd on other grounds*, 336 U.S. 281 (1949).

¹³⁵ 40 U.S.C. § 325a (1940).

¹³⁶ 297 N.Y. at 225, 78 N.E.2d at 484.

¹³⁷ 98 F.2d 781, 788-89 (2d Cir.), *cert. denied*, 305 U.S. 651 (1938).

¹³⁸ 240 F. Supp. 709 (W.D. La. 1965), *aff'd*, 370 F.2d 847 (5th Cir.), *cert. denied*, 388 U.S. 911 (1967).

¹³⁹ The only case cited in *Weinberger* to support its view that the agreement required by § 6 (a)(1) is "a separate contract supported by mutual consideration," 335 F. Supp. at 144, is *Fryns v. Fair Lawn Fur Dressing Co.*, 114 N.J. Eq. 462, 168 A. 862 (1933). In that case, the consideration for a "re-employment agreement" with the President of the United States under the National Industrial Recovery Act of 1933, 48 Stat. 195 (1933), was found to be "the benefit of the pledge of all other members of N.R.A. to patronize their fellow members," *id.* at 468, 168 A. at 865. It seems plainly irrelevant.

¹⁴⁰ The rights acquired by an exchange are subject to such conditions and restrictions, and amendments to or revocations of such conditions and restrictions, as Congress sees fit to impose. *See, e.g.*, *Fochi v. Splain*, 36 N.Y.S.2d 774 (Sup. Ct. N.Y. County 1942). The right of the exchange to conduct its business is not a "franchise," as the *Weinberger* decision implies, 335 F. Supp. at 144, n.12, since a "franchise" cannot be taken away by the United States except under the power of eminent domain. *See, e.g.*, *New Orleans Gas Co. v. Louisiana Light Co.*, 115 U.S. 650, 673 (1885). As the New York Court of Appeals stated in *Schram v. Cotton*, 281 N.Y. 499, 507, 24 N.E.2d 305, 308 (1939): "A voluntary promise to assume a duty or liability, which the law imposes even where there is no promise, creates no new duty or liability."

¹⁴¹ *See Schram v. Cotton*, 281 N.Y. 499, 24 N.E.2d 305 (1939). In *Schram*, defendant was sued by the receiver of an insolvent national bank for recovery of the double liability imposed by the statute on stockholders of national banks. Defendant had consolidated his stockholdings with other stockholders in a holding company. The articles of association of the holding company provided that the stockholders "severally agree that such liability may be enforced in the same manner and to the same extent as statutory liability." *Id.* at 506, 24 N.E.2d at 308. Defendant argued that a three-year statute of limitations for liability created by statute found in N.Y. CODE CIV. PROC. § 394 (McKinney 1971) was to be applied instead of the six-year contract statute of limitations in N.Y. CODE CIV. PROC. § 382(1) (McKinney 1971). The court adopted the three-year period for liabilities created by statute. Judge Lehman, after reciting the principle that the contractual assumption of a duty already imposed by the law in the absence of such a promise creates no new duty or liability, stated:

To hold that the action to enforce the statutory liability imposed upon stockholders of the bank, which has been expressly assumed by the stockholders of the dominant corporation, is governed

Presumably, the registration provisions of section 6 were couched in voluntary "agreement" terms to encourage the self-regulators to enforce compliance with "ethical as well as legal standards."¹⁴² The ultimate power of oversight was vested in the SEC by sections 19(a) and (b).¹⁴³ The "agreement"¹⁴⁴ was a condition precedent to Commission approval of an exchange's registration application and comported with the position, espoused by the draftsmen of the Act, that exchanges should be licensed.

For instance, in 1933 President Roosevelt directed Secretary of Commerce Daniel Roper to appoint a Federal Interdepartmental Committee on Stock Exchanges (the "Roper Committee") to examine the extent to which governmental control should supersede the existing system of exchange self-regulation. In January 1934, the Roper Committee recommended the federal licensing of exchanges.¹⁴⁵ The Roper Report stated:

In the event a Federal *license* should be required of all exchanges as above proposed there would be attached to the *license* as a condition of issue and continued enjoyment the following requirement, viz.: That all exchanges desiring a Federal *license* must adopt and submit to the proposed Stock Exchange Authority for its approval, rules designed to comply with the regulatory requirements outlined by the proposed statute and with such rules and regulations as may be promulgated by the proposed Stock Exchange Authority thereunder. Furthermore, as a condition of retaining a *license* an exchange would be required to abide by and enforce such regula-

by a different Statute of Limitations from that which governs an action to enforce the statutory liability impliedly assumed by the stockholders of the bank when they acquire their stock, would exalt form over substance.

281 N.Y. at 507, 24 N.E.2d at 308. *Accord*, *Platt v. Wilmot*, 193 U.S. 602, 613 (1904) ("It is a liability created by the statute, because the statute is the foundation for the implied contract"); *McClaine v. Rankin*, 197 U.S. 154, 162 (1905).

Similarly, in *Abram v. San Joaquin Cotton Oil Co.*, 46 F. Supp. 969 (S.D. Cal. 1942), the court was faced with a statute of limitations issue in a laborer's action for overtime compensation and rejected a defense that the cause of action was subject to a two-year statute of limitations for contract actions rather than a three-year statute for liability created by statute. *Accord*, *Lorenzetti v. American Trust Co.*, 45 F. Supp. 128, 139 (N.D. Cal. 1942), *rev'd on other grounds sub nom. Rosenberg v. Semeria*, 137 F.2d 742 (9th Cir.), *cert. denied*, 320 U.S. 770 (1943); *City Messenger Serv., Inc. v. Capitol Records Distrib. Corp.*, 327 F. Supp. 970, 973 (S.D. Ohio 1970), *aff'd*, 446 F.2d 6 (6th Cir. 1971), *cert. denied*, 404 U.S. 1059 (1972) ("The statute is as necessary a basis for the plaintiff's cause of action as it is for the jurisdiction of this Court"); *Hire v. E.I. DuPont De Nemours & Co.*, 324 F.2d 546, 551 (6th Cir. 1963) ("the Labor Agreement provided for the benefit but the Act gave it vitality"). *See generally* *Bevelander v. Town of Islip*, 10 A.D.2d 170, 171-72, 199 N.Y.S.2d 561, 563 (2d Dep't 1960).

142 *Silver v. New York Stock Exch.*, 373 U.S. 341, 371 (1963) (Stewart, J., dissenting). Prior to enactment of the Exchange Act, exchanges viewed themselves as private clubs, insulated from governmental or judicial control. *See* text accompanying notes 82-86 *supra*.

143 15 U.S.C. §§ 78(a), (b) (1976 & Supp. 1978).

144 An earlier draft of the proposed Exchange Act had not contained the term "agreement." *See Hearings on H.R. 7852 and 8720 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 4 (1934). This language was added later, *see* H.R. 9323, 73d Cong., 2d Sess. (1934); S. 3420, 73d Cong., 2d Sess. (1934), notwithstanding the suggestion by the New York Stock Exchange that there be no reference to an agreement. *See Hearings on S. Res. 84, S. Res. 56 and S. Res. 97 before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess. 7545 (1934). Judge Gurfein in *Weinberger*, in view of the legislative history, concluded that the use of the term "agreement" was deliberate. 335 F. Supp. at 145.

There is no dispute with this proposition. On the other hand, the fact that the term "agreement" was employed in the statute does not necessarily mean that the "agreement" thereby rose to the level of an independent contract. *See* text accompanying notes 126-27 *supra*. The "agreement" filed by the New York Stock Exchange simply provided that the Exchange would act in accordance with the statutory mandate. *See* note 105 *supra*.

145 STAFF OF SENATE COMM. ON BANKING AND CURRENCY, 73D CONG., 2D SESS., STOCK EXCHANGE REGULATION: LETTER FROM PRESIDENT TO CHAIRMAN OF COMMITTEE ON BANKING AND CURRENCY WITH AN ACCOMPANYING REPORT RELATIVE TO STOCK EXCHANGE REGULATION (Comm. Print 1934) [hereinafter cited as *ROPER REPORT*].

tory requirements and such rules and regulations. Any exchange would be permitted to adopt any other or additional rules and regulations not inconsistent with the regulatory requirements outlined by the statute or the rules and regulations promulgated by such proposed Stock Exchange Authority.

. . . .

In order to entitle itself to a *license*, an exchange must submit its rules to the Stock Exchange Authority, above described. These rules must contain provisions embodying as a minimum at least the regulatory requirements suggested hereinafter and must be in a form which satisfies the Authority that they are at least as stringent as the standard set out in the statute, although they may be more so. If at any time, on complaint or otherwise, the agency is satisfied that a particular *licensed* exchange is not vigilantly or effectively enforcing any of the rules in question by expulsion, suspension, fine or otherwise of its members, such exchange, after a hearing, if found guilty, shall be deprived of its *license*, or suspended.¹⁴⁶

Numerous other references to exchange licensing abound in the Roper Report,¹⁴⁷ the precursor of the Securities Exchange Act of 1934.¹⁴⁸

During the legislative hearings, Thomas Corcoran, one of the principal draftsmen of the Securities Exchange Act,¹⁴⁹ repeatedly characterized the proposed federal regulatory scheme in terms of a license. For example, Mr. Corcoran stated that "after appropriate notice and opportunity for hearing the Commission may suspend the registration of a securities exchange; that is withdraw its license to do business."¹⁵⁰ Similarly, Assistant Secretary of Commerce John Dickinson, the Chairman of the Roper Committee, expressed the view that "an exchange should not be licensed unless its rules and regulations provide adequate prohibitions against unfair and improper practices and against practices tending to the overstimulation of speculation."¹⁵¹

As has been suggested by the courts, a license is a permit to do what otherwise would be unlawful. A license regulates and controls the manner in which a business is conducted, and prevents its being carried on to injure public interests. "A license is a mere privilege, and is not a contract." It does not create a vested right.¹⁵²

In short, the purported "contract" is illusory. But for section 6, the duty of an exchange to enforce its rules—and any cause of action for breach of that duty—would not exist.¹⁵³ One commentator has observed:

A few courts have, without critical examination, cited *Weinberger* as standing for the investor's right to recover as a third-party beneficiary of an exchange's contract with the SEC. Still, it seems that that decision is incorrect. The contracts involved in securities transactions are those between the exchange and its members and between members and investors; the agreement filed by an exchange with the SEC under former section 6 seems to be merely the satisfaction of the Exchange Act's then-ex-

146 *Id.* at 11, 12 (emphasis supplied).

147 *See id.* at 4, 8-9, 20.

148 15 U.S.C. §§ 78a-kk (1976 & Supp. 1978).

149 *See Stock Exchange Practices: Hearings on S. Res. 84, S. Res. 56 and S. Res. 97 before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess. 6463 (1934).

150 *Id.* at 6566, 6569, 6573.

151 *Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 505, 514-15 (1934).

152 *Palmetto Fire Ins. Co. v. Beha*, 13 F.2d 500, 505 (S.D.N.Y. 1925). *See generally* *Madden v. Queens County Jockey Club*, 296 N.Y. 249, 255, 72 N.E.2d 697, 699, *cert. denied*, 332 U.S. 761 (1947).

153 *Cf. Frank Shepard Co. v. Zachary P. Taylor Publishing Co.*, 234 N.Y. 465, 468, 138 N.E. 409, 410 (1923) (for statute of limitations purposes, a liability created by statute means a liability which would not exist but for the statute).

isting conditions precedent for licensing. . . . The mere fact that the statute called for an exchange to include an agreement to enforce with the rest of its registration statement should not transform the statutory duty into a contractual one.

Even if the agreement filed by an exchange with the SEC is considered a "contract," it is not clear that an individual investor should be regarded as an "intended beneficiary." Every contract made by a governmental unit or agency is presumably made for the benefit of its citizens. Nevertheless, actual performance of the registration "contract" does not run to the investing public. Furthermore, it is doubtful whether specific investment losses to individual investors are "foreseeable" within the more restricted ambit of contract concepts of foreseeability.¹⁵⁴

Congress deleted the requirement for such an "agreement" in the Securities Acts Amendments of 1975¹⁵⁵ with no apparent regard for any party's "contract" rights.¹⁵⁶

IV. Time on Overcome Inertia?

Since its decision in 1944, *Baird v. Franklin*¹⁵⁷ has been mechanically followed by the lower courts.¹⁵⁸ However, in view of *Baird's* reasoning, its conflict with the principles set forth in recent Supreme Court decisions,¹⁵⁹ and Congress's recent reaffirmation of the SEC's dominant role in overseeing exchange performance under the Exchange Act,¹⁶⁰ the precedential value of *Baird v. Franklin* should be seriously questioned. Moreover, since the term "agreement" has been deleted from an exchange's registration statement, the *Weinberger* contract theory should be moribund. Recently, after applying the *Redington* and *Transamerica* standards, the Ninth Circuit held that investors have no implied private right of action under section 6 or stock exchange rules promulgated thereunder.¹⁶¹ Several district judges in the Third Circuit have indicated their acquiescence in this holding.¹⁶² In an effort to salvage *Baird*, a district judge in the Second Circuit, the birthplace of *Baird*, was forced to conclude that the principles of *Cort*, as refined by *Redington* and *Transamerica*, were "at least modified, and perhaps over-ridden" in view of *Baird's* long history.¹⁶³

154 Comment, *Exchange Liability for Improper Enforcement of Its Constitution and Rules: The Investor's Right of Action Under the Securities Exchange Act of 1934*, 24 EMORY L.J. 865, 878 (1975).

155 Pub. L. No. 94-29, 89 Stat. 137 (1975).

156 In *Weinberger*, the court raised but did not decide the question whether the agreement itself could sustain federal question jurisdiction under 28 U.S.C. § 1331(a). See 335 F. Supp. at 146. The legislative history demonstrates that the agreement was a precondition to licensing. If such an agreement could give rise to federal question jurisdiction as an action which arises under the laws of the United States, then presumably any federally licensed business or person (including lawyers admitted to practice before the federal judiciary) could be sued under 28 U.S.C. § 1331 by any member of the public claiming to be an intended third party beneficiary of the license. A court should tread warily in this area. The author believes that the deletion of the term "agreement" should render this issue moot, unless the present statutory language in § 6(a) is so tortured as to give rise to an implied contract.

157 141 F.2d 238 (2d Cir.), cert. denied, 323 U.S. 737 (1944).

158 See Note, *Exchange Liability for Net Capital Enforcement*, 73 COLUM. L. REV. 1262, 1273 (1973): "After *Baird*, courts considering exchange liability have usually cited *Baird*, particularly Judge Clark's opinion, as precedent and avoided elaborate supporting arguments."

159 See text accompanying notes 14-52 *supra*.

160 *Id.*

161 See *Jablon v. Dean Witter & Co.*, 614 F.2d 677 (9th Cir. 1980) (no private right of action under § 6 could be implied since there were no affirmative indications that Congress intended such a right).

162 See, e.g., *Lenowitz Bi-Planning Security Corp. v. Philadelphia Stock Exch.*, [Current] FED. SEC. L. REP. (CCH) ¶ 97,801 (E.D. Pa. 1980); *Hoover v. E.F. Hutton & Co.*, Civ. No. 79-3475 (E.D. Pa. 1980).

163 See *Rich v. New York Stock Exch.*, Civ. No. 73-4642 (S.D.N.Y. 1981) (Leval, J.). *Rich* arose out of the demise of Weis Securities, Inc., a former member firm. See text accompanying notes 31-41 *supra*. But see *Verace v. New York Stock Exch.*, 478 F. Supp. 1061, 1065 (S.D.N.Y. 1979) (suggesting in dictum that

The broad and pervasive scope of the Exchange Act might be undermined and its purposes frustrated, however, if different district courts intruded upon the regulation expressly entrusted to the SEC. For example, a recent section 6 case, *Baty v. Pressman, Frohlich & Frost, Inc.*,¹⁶⁴ concerned the extent to which the New York Stock Exchange could be held liable for failing to supervise adequately the actions of an employee of a member firm. Previously, the employee in question had been suspended by the SEC for fifty days for making purchase recommendations in non-registered securities. The SEC, though, subsequently approved the employee's re-employment by a brokerage firm in light of apparent good faith in making such recommendations.

The New York Stock Exchange conducted its own investigation of the questioned transactions, acceded to the SEC's position regarding re-employment, and advised his new employer, Pressman, Frohlich & Frost, Inc., "to exercise more than ordinary supervision" over the employee. Claiming to have been subsequently defrauded by the employee, the plaintiff sued the New York Stock Exchange,¹⁶⁵ the presumed deep pocket, and alleged that the Exchange itself was required to monitor closely the actions of this particular employee.¹⁶⁶ In denying the Exchange's motion for summary judgment, the court believed the Exchange should have provided more than ordinary supervision.¹⁶⁷ The Exchange argued its duty had been discharged when it notified the member. At that time, compliance with the Exchange's directive became the member's responsibility. Although the claims were eventually dismissed, the case underscores the problem resulting when courts second-guess exchange supervision and impose their own notions of regulatory efficiency and equity upon self-regulatory organizations.¹⁶⁸

The problem of judicial interference increases when judicial determinations conflict with those of the SEC. *Hughes v. Dempsey-Tegeler & Co.*¹⁶⁹ illustrates this point. In *Hughes*, the Ninth Circuit found the New York Stock Exchange had

the *Redington* analysis countermands implication of a private right of action under § 6 even for public investors).

164 [Current] FED. SEC. L. REP. (CCH) ¶ 97,556 (S.D.N.Y. June 26, 1980).

165 The brokerage house was in liquidation.

166 At the time of the alleged breach of duty by the New York Stock Exchange in *Baty* (circa December 1972), the Exchange had 1,366 members, the majority of whom were associated with 558 member organizations. Such member organizations had a total of 3,751 branch offices located in all 50 states, Puerto Rico, the Virgin Islands and more than 20 foreign countries. Those member organizations employed approximately 51,000 persons as registered representatives. Not surprisingly, it has been held that an exchange's duty to supervise its members is not "fluoroscopic." See *Rich v. New York Stock Exch.*, 379 F. Supp. 1122, 1126 (S.D.N.Y. 1974), *rev'd on other grounds*, 522 F.2d 153 (2d Cir. 1975); *Hochfelder v. Midwest Stock Exch.*, 350 F. Supp. 1122, 1124-25 (N.D. Ill. 1972), *aff'd*, 503 F.2d 364, 367 (7th Cir.), *cert. denied*, 419 U.S. 875 (1974).

167 471 F. Supp. 390 (S.D.N.Y. 1979).

168 As noted by the court in *Hochfelder v. Midwest Stock Exch.*, 503 F.2d 364, 367 (7th Cir.), *cert. denied*, 419 U.S. 875 (1974):

Although the section 6 duty of self-regulation is framed in broad language, "to enforce so far as is within its power", it is not a mandate of strict liability rendering the exchange a guarantor of all fraudulent schemes consummated by its members whether in listed or unlisted securities. To so read section 6 would tear at the very fabric of self-regulation, a burden which indeed no self-regulatory body could bear.

See generally *Intercontinental Indus., Inc. v. American Stock Exch.*, 452 F.2d 935 (5th Cir. 1971), *cert. denied*, 409 U.S. 842 (1972); *J.R. Williston & Beane, Inc. v. Haack*, 387 F. Supp. 173 (S.D.N.Y. 1974); *Aronson v. McCormick*, 13 Misc. 2d 1077, 178 N.Y.S.2d 957 (Sup. Ct. N.Y. County), *aff'd*, 6 A.D.2d 999, 177 N.Y.S.2d 1004 (1st Dep't 1958).

169 534 F.2d 156 (9th Cir.), *cert. denied*, 429 U.S. 896 (1976).

violated its section 6 duties by lifting various restrictions imposed upon a member firm that had violated the Exchange's net capital rule. The court wrote:

We are bothered by the fact that the action of the Commission paralleled that of the Exchange in that the Commission lifted its prohibition on underwritings by the firm at the same time that the Exchange lifted its restrictions. The breach in this case is *so clear*, however, that the weight to be accorded to the Commission's action does not alter our conclusion.¹⁷⁰

Although the breach may have been "so clear" to the court of appeals, it was not "so clear" to the district court which, in an opinion conceded by the court of appeals to be a scholarly and prodigious effort,¹⁷¹ found no such breach.¹⁷² And the breach surely was not "so clear" to the SEC.

The SEC alone has "intimate familiarity with the characteristic features of the [securities] industry"¹⁷³ Recognizing administrative expertise in *Far East Conference v. United States*,¹⁷⁴ the Supreme Court gave, for the guidance of the lower federal courts, a classic expression of the long-established principle of primary jurisdiction:

[A] principle, now firmly established, [is] that in cases raising issues of fact not within the conventional experience of judges or cases requiring the exercise of administrative discretion, agencies created by Congress for regulating the subject matter should not be passed over. This is so even though the facts after they have been appraised by specialized competence serve as a premise for legal consequences to be judicially defined. Uniformity and consistency in the regulation of business entrusted to a particular agency are secured, and the limited functions of review by the judiciary are more rationally exercised, by preliminary resort for ascertaining and interpreting the circumstances underlying legal issues to agencies that are better equipped than courts by specialization, by insight gained through experience, and by more flexible procedure.¹⁷⁵

Thus, subject to judicial review after action by the regulatory agency, the determination of reasonable rail tariffs has been left to the Interstate Commerce Commission;¹⁷⁶ the determination of unfair labor practices has been left to the National Labor Relations Board;¹⁷⁷ questions regarding the organization or operation of a new bank by a bank holding company are within the exclusive jurisdiction of the Federal Reserve Board;¹⁷⁸ and the evaluation of the antitrust implications of certain practices of the Chicago Mercantile Exchange is within the purview of the Commodity Exchange Commission.¹⁷⁹

As the Supreme Court has noted, "where Congress has created a special administrative procedure for the determination of the status of persons or companies under a regulatory act and has prescribed a procedure which meets all re-

¹⁷⁰ 534 F.2d at 174 (emphasis added).

¹⁷¹ *Id.* at 166.

¹⁷² *See Hughes v. Dempsey-Tegeler & Co.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,133 (C.D. Cal. 1974).

¹⁷³ *United States v. Morgan*, 118 F. Supp. 621, 699 (S.D.N.Y. 1953). *See also* Robert W. Stark, Jr., Inc. v. New York Stock Exch., 346 F. Supp. 217 (S.D.N.Y.), *aff'd*, 466 F.2d 743 (2d Cir. 1972).

¹⁷⁴ 342 U.S. 570 (1952).

¹⁷⁵ *Id.* at 574-75.

¹⁷⁶ *Texas & P. Ry. Co. v. Abilene Cotton Oil Co.*, 204 U.S. 426 (1907).

¹⁷⁷ *Garner v. Local 776, Int'l Bhd. of Teamsters*, 346 U.S. 485 (1953).

¹⁷⁸ *Whitney Nat'l Bank v. Bank of New Orleans & Trust Co.*, 379 U.S. 411, 419 (1965).

¹⁷⁹ *Ricci v. Chicago Mercantile Exch.*, 409 U.S. 289 (1973).

quirements of due process, that remedy is exclusive."¹⁸⁰ This precept has been adhered to by courts in many different situations. In *United Gas Corp. v. Pennzoil Co.*,¹⁸¹ an attempt to enjoin the defendant from acquiring plaintiff's stock upon the ground the acquisition would contravene the Public Utility Holding Company Act was denied. According to the court,

In the case at bar [plaintiff] seeks to have this court, before any of the procedures provided by the Act have been or, indeed, could be invoked, predetermine the very matters which Congress has expressly directed should be entrusted to the S.E.C. Were the court to follow that course it would be usurping the functions of the S.E.C. and flying in the face of the congressional mandate. Such a course is quite beyond the powers of this court, equitable or otherwise and, indeed, would be basically unsound.¹⁸²

Similarly, in *Gordon v. New York Stock Exchange*,¹⁸³ the Supreme Court held that the Exchange's practice of fixing commission rates is not within a federal court's jurisdiction because oversight of this aspect of exchange self-regulation is vested in the SEC by section 19(b) of the Exchange Act.

The Supreme Court's refusal in *Securities Investor Protection Corp. v. Barbour*¹⁸⁴ to imply a private right of action because of such a right's incompatibility with the regulatory scheme is particularly instructive. *Barbour* involved determination of whether customers of a failing broker-dealer had "an implied private right of action under the Securities Investor Protection Act of 1970¹⁸⁵ . . . to compel SIPC to exercise its statutory authority for their benefit."¹⁸⁶ In denying that the plaintiff had a right to obtain an order compelling SIPC to invoke the statutory provisions for the benefit of the broker-dealer's customers, the Court focused on the regulatory scheme established by Congress. The Court noted that because of receivership's severe effect, the application for the appointment of a receiver was considered by SIPC to be "a last resort."¹⁸⁷ SIPC's constant monitoring of broker-dealers provided data with which it could determine whether an application for appointment of a receiver was essential in a particular case or whether a problem could be solved through less drastic means. The disruption a private right of action would create underscored the conclusion that no private right of action should be implied.

Nevertheless, it has been suggested that the *Baird* rule be "grandfathered," akin to treatment accorded to sections 10(b)¹⁸⁸ and 14(a)¹⁸⁹ of the Exchange Act. Indeed, this is the premise of a recent decision upholding *Baird*.¹⁹⁰ However, this

180 *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 404 (1940). See also *Anniston Mfg. Co. v. Davis*, 301 U.S. 337 (1937); *Rawls v. United States*, 331 F.2d 21 (8th Cir. 1964).

181 248 F. Supp. 449 (S.D.N.Y.), *aff'd*, 354 F.2d 1002 (2d Cir. 1965).

182 248 F. Supp. at 454.

183 422 U.S. 659 (1975).

184 421 U.S. 412 (1975).

185 15 U.S.C. §§ 78aaa-III (1976 & Supp. 1978).

186 421 U.S. at 413-14.

187 *Id.* at 421.

188 15 U.S.C. § 78j(b) (1976). In *Cannon v. University of Chicago*, 441 U.S. 677, 692 n.13 (1979), the Supreme Court explained its former decision in *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971) (implying private right of action under § 10(b) and rule 10b-5), as an acquiescence in the 25-year old acceptance by the lower federal courts of such a cause of action. Of course, the *Bankers Life* decision antedated the *Redington* analysis, which has greatly limited judicial implication of private rights of action.

189 15 U.S.C. § 78n(a) (1976). See *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964).

190 See *Rich v. New York Stock Exch.*, Civ. No. 73-4642 (S.D.N.Y. 1980).

is an insufficient and unpersuasive justification for retaining a precedent whose underpinnings have been overruled *sub silentio* by the Supreme Court. Denying securities investors a negligence-based private damage action against a self-regulatory organization would simply require such investors to bear the same risk of loss bank depositors or investors in money market instruments now bear. Bank depositors have no right of action for negligence against national bank examiners or the Comptroller of the Currency.

To be sure, a self-regulatory organization is only a quasi-administrative agency and is not *ipso facto* entitled to the sovereign immunity accorded government agencies such as the SEC. On the other hand, a national securities exchange often acts in partnership with the SEC in many respects and exercises quasi-governmental powers in discharging its responsibilities under the Exchange Act.¹⁹¹ Shielding an exchange from liability where it acts in good faith would comport with the principle of self-regulation.¹⁹² As set forth in the legislative history to the Securities Acts Amendments of 1975,

[Self-regulatory] organizations should never be placed in the position of being insurers of their members' compliance [with the Exchange Act and regulations thereunder]. They do, however, have an obligation to enforce applicable provisions of the Exchange Act, and their own rules which they should not be permitted to avoid except for good cause.¹⁹³

Abolishing the *Baird* rule would not affect the public investor's right to sue an exchange for an intentional tort such as fraud.¹⁹⁴

191 See S. REP. NO. 75, 94th Cong., 1st Sess. 24, reprinted in [1975] U.S. CODE CONG. & AD. NEWS 179, 202-03.

192 Section 19(h)(4) of the Exchange Act, for example, imposes sanctions against self-regulatory officials who act *willfully*. Cf. Exchange Act § 20, 15 U.S.C. § 78b (good faith as partial defense for "controlling persons"). An exchange has not been held to be a "controlling person" under the Act. See *Carr v. New York Stock Exch.*, 414 F. Supp. 1292 (N.D. Cal. 1976). Accord, *Baty v. Pressman, Frohlich & Frost, Inc.*, 471 F. Supp. 390 (S.D.N.Y. 1979).

At common law, a claim against an exchange for breach of a duty to supervise its members did not exist. See, e.g., *New York Stock Exch. v. Goodbody & Co.*, 42 A.D.2d 556, 345 N.Y.S.2d 58 (1st Dep't 1973); *Raldiris v. Simmons*, 266 N.Y. 577, 195 N.E. 208 (1935); *Morganbesser v. New York Stock Exch.*, [1971-72 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,210 (Sup. Ct. Nassau County 1971); *New York Stock Exch. v. Pickard & Co.*, 282 A.2d 651 (Del. Ch. 1971); *Krasnow v. Kern Sec. Corp.*, 175 N.Y.L.J., May 17, 1976, at 8, col. 6 (Sup. Ct. N.Y. County).

However, it is theoretically possible to posit a common law action against a national securities exchange through application of an expanded fiduciary duty doctrine. Although in *Baird v. Franklin*, 141 F.2d 238, 245-46 (2d Cir.), cert. denied, 323 U.S. 737 (1944), the court held that an exchange was not a fiduciary (since exchange responsibilities did not encompass safeguarding securities or cash and were limited solely to investigating and disciplining its members), at least one commentator, consistent with Judge Clark's dissent in *Baird*, has suggested that an exchange is a fiduciary. See Note, *Exchange Liability for Net Capital Enforcement*, 73 COLUM. L. REV. 1262, 1281 (1973):

There are [strong] reasons today for calling an exchange a fiduciary. First, the growth of pension, trust and mutual funds has brought the general public into the market. Second, widespread advertising, particularly by the NYSE, has encouraged public trading by emphasizing customer protection from broker losses and suggesting that the exchanges perform a fiduciary role.

Yet, the fact that an exchange may advertise to the public at large or exercise oversight of member firms, through whom fiduciary funds may be invested or with whom fiduciary funds may be entrusted, does not thereby mean that an exchange itself is or should be a fiduciary. The majority opinion in *Baird*, to the extent that it recognizes that an exchange actually has no direct fiduciary duties, seems sound. In any event, this is a matter that should await legislative initiative.

193 S. REP. NO. 75, 94th Cong., 1st Sess. 34, reprinted in [1975] U.S. CODE CONG. & AD. NEWS 179, 211.

194 See, e.g., *Raldiris v. Simmons*, 266 N.Y. 577, 195 N.E. 208 (1935) (New York Stock Exchange). See also *Aronson v. McCormick*, 13 Misc. 2d 1077, 178 N.Y.S.2d N57 (Sup. Ct. N.Y. County), *aff'd*, 6 A.D.2d 999, 177 N.Y.S.2d 1004 (1st Dep't 1958) (American Stock Exchange). Common law decisions have also

Baird should be retained if its existence has ensured efficient and diligent regulation by self-regulatory organizations.¹⁹⁵ However, empirical study in this area has not been undertaken and no definitive conclusion can be reached. Since no private investor has obtained a monetary judgment against an exchange under section 6, the threat to an exchange arising from the possibility of such a judgment may be more illusory than real.¹⁹⁶ The threat that an exchange's registration will be revoked by the SEC—which sanction has been applied, albeit in only one instance¹⁹⁷—probably provides a more potent deterrent. Moreover, recent increases in SIPC insurance limits should minimize instances where a public investor might suffer losses not covered by SIPC, as from the failure of a member firm.¹⁹⁸

held that a contract market may be held liable for damages resulting from action ordered in bad faith by its board of directors. *See, e.g.,* *Garcia Sugars Corp. v. New York Coffee & Sugar Exch.*, 7 N.Y.S.2d 532 (Sup. Ct. N.Y. County 1938), *aff'd sub nom. Rifkind v. New York Coffee & Sugar Exch.*, 258 A.D. 871, 16 N.Y.S.2d 1023 (1st Dep't 1939). *Accord, P.J. Taggares Co. v. New York Mercantile Exch.*, 476 F. Supp. 72 (S.D.N.Y. 1979); *Lagorio v. Bd. of Trade*, 529 F.2d 1290 (7th Cir.), *cert. denied*, 426 U.S. 950 (1976). *Cf. Daniel v. Board of Trade*, 164 F.2d 815 (7th Cir. 1947). In this regard, the fourth prong of the *Cort* test makes it clear that no federal cause of action should be implied if the action is already cognizable at common law.

195 Despite concern that the maintenance of a private right of action against an exchange would unduly burden the courts, this has not turned out to be the case. While the post-1968 financial crisis in the securities industry did produce a series of 21 suits, many of them quite complex in scope, there is no firm evidence that the judicial machinery was in danger of breaking down. *See generally* Note, *supra* note 79, at 117 n.46.

196 Besides *Baird v. Franklin*, the courts have found that an exchange has breached its § 6 duty on only two occasions. In *Bright v. Philadelphia-Baltimore-Washington Stock Exch.*, 327 F. Supp. 495 (E.D. Pa. 1971), the P-B-W's Board of Directors had maneuvered to elect only nine of its constitutionally prescribed ten directors. Plaintiff, an independent nominee, obtained a declaratory judgment that the exchange had failed to comply with its internal election procedures. *See generally* text accompanying note 86 *supra*.

In *Hughes v. Dempsey-Tegeler & Co.*, 534 F.2d 156 (9th Cir.), *cert. denied*, 429 U.S. 896 (1976), the New York Stock Exchange was held to have breached a § 6 duty to a subordinated lender when it lifted certain restrictions previously imposed upon a brokerage firm for violation of the Exchange's net capital rules. Plaintiff did not recover damages, however, since the court found that he had waived his right to sue the Exchange by conditioning the execution of his subordination agreement upon the very lifting of the restrictions he now sought to attack as improper.

The lack of success of private § 6 suits reflects, in part, the difficult hurdles a plaintiff must overcome in proving his case. Under the tort standard of *Baird* and its progeny, a plaintiff bears the burden of proving (i) a breach of duty by the exchange, judged against all the facts and circumstances of a particular case, and (ii) that the breach proximately caused injury. In cases where it is alleged that exchange actions were inadequate, plaintiff must show that an exchange (i) should have performed differently, (ii) could have performed differently, and (iii) but for the failure of an exchange to so perform, the losses incurred could have been prevented. *See generally* *Brennan v. Midwestern Life Ins. Co.*, 286 F. Supp. 702 (N.D. Ind. 1968), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970) (applying concept of foreseeability of loss). Moreover, plaintiffs in *Bright* and *Hughes* could not likely pursue each § 6 claims today. *See* text accompanying notes 8-10 *supra*. *See also* *Lenowitz Bi-Planning Security Corp. v. Philadelphia Stock Exch.*, [Current] FED. SEC. L. REP. (CCH) ¶ 97,801 (E.D. Pa. 1980) (questioning vitality of the *Bright* decision).

197 *See* *San Francisco Mining Exch. v. SEC*, 378 F.2d 162 (9th Cir. 1967).

198 Prior to October 10, 1980, customer accounts, pursuant to the Securities Investor Protection Act of 1970 (SIPA), 15 U.S.C. §§ 78aaa-III (1976 & Supp. 1978), were insured up to \$100,000 (except that claims for cash, as distinct from claims for securities, could not exceed \$40,000). *See* 15 U.S.C. § 78fff-3 (Supp. 1978). Effective October 10, 1980, SIPA was amended to increase the insurance coverage from the \$100,000/\$40,000 level to \$500,000/\$100,000. *See* Pub. L. No. 96-433, 94 Stat. 1855 (1980). The legislative history reveals that the purpose of this amendment was three-fold: (i) to match the recently increased insurance levels for deposits with federally insured banks, (ii) to provide for further customer confidence in dealing with individual securities firms, and (iii) to promote the immobilization of stock certificates by encouraging customers to maintain their securities with broker/dealers. *See* H.R. REP. NO. 1321, 96th Cong., 2d Sess. 1, 1-2 reprinted in [1980] U.S. CODE CONG. & AD. NEWS 7250-51.

SIPA is funded by assessments paid by the securities industry. At the present time, the SIPC trust fund exceeds \$200 million. *Id.* Since member assessments, a cost of doing business, are presumably shifted by broker-dealers to investors, the increase in SIPA limits should ultimately be borne by investors. That

Regrettably, the ALI Federal Securities Code¹⁹⁹ has skirted the issue of an express private right of action under what is now section 6 of the Exchange Act. Although the Code makes express a private right of action for violations in sections 7,²⁰⁰ 10²⁰¹ and 14²⁰² of the Exchange Act, the issues raised by *Baird* are left to judicial development.²⁰³ Under the tests for the implication of a private right of action enunciated in section 1722 of the Code,²⁰⁴ *Baird's* survival is uncertain.²⁰⁵

In his reporter's notes to the Code, Professor Louis Loss writes:

Even if it were assumed that all these lower court holdings [such as *Baird v. Franklin*] should be codified into express civil liability provisions, it would be impractical to do so. And, in any event, cases under other provisions would continue to crop up . . . unless the Code were affirmatively to foreclose all private actions as § 410(g) of the Uniform Securities Act does . . . Further judicial development is as essential as it is unavoidable.²⁰⁶

Although Professor Loss's concern against foreclosing common law development

investors, the users of the market, should be the payers of this kind of insurance seems only fair and economically efficient.

199 The Federal Securities Code has been adopted by the American Law Institute and was recently endorsed by the SEC. See [Current] FED. SEC. L. REP. (CCH) ¶ 82,655 (Sept. 18, 1980). The Code is now before the Congress.

200 15 U.S.C. § 78g (1976).

201 15 U.S.C. § 78j (1976).

202 15 U.S.C. § 78n (1976).

203 Under § 1822(a)(2) of the Code, federal courts have concurrent (not exclusive) jurisdiction of civil actions created by or based on a violation of the Code. *Baird* would fall in the category of an action based on a violation of the Code. State courts faced with the question of whether or not to follow *Baird* would be required to apply federal common law, a "reverse *Erie*" [*Erie R.R. v. Tompkins*, 304 U.S. 64 (1938)] situation. See 2 ALI, FEDERAL SECURITIES CODE § 1822, Comment 5 (1980).

204 2 ALI, FEDERAL SECURITIES CODE § 1722(a) (1980). Section 1722(a) provides, in relevant part:

(a) IMPLIED ACTIONS.—A court, considering the nature of the defendant's conduct, the degree of his culpability, the injury suffered by the plaintiff, and the deterrent effect of recognizing a private action based on a violation of this Code, may recognize such an action even though it is not expressly created by part XVII [of the Code, dealing with Civil Liability], but only if (1) the action is not inconsistent with the conditions or restrictions in any of the actions expressly created or with the scheme of this Code, (2) the provision, rule, or order that is the basis of the action is designed for the special benefit of a class of persons to which the plaintiff belongs against the kind of harm alleged, (3) the plaintiff satisfies the court that under the circumstances the type of remedy sought is not disproportionate to the alleged violation, and (4) in cases . . . that specif[y] a maximum measure of damages, a comparable maximum is imposed.

205 It is the author's view that implication of a private right of action under § 6 is inconsistent with the present statutory scheme because it usurps or potentially usurps the role of the SEC. See text accompanying notes 91-122, 168-175 *supra*. It can be further argued that, at the very least, implication of a private right of action in favor of public investors is inconsistent with implication of such a right in favor of partners in member firms and subordinated lenders. See note 10 *supra*. But see Note, *supra* note 79. Moreover, it also appears that the second factor set forth in § 1722(a) is not met in this case either. The Supreme Court has specifically held that courts should not infer an intent to create a private remedy merely from Congress's expressed desire to benefit the public generally. See, e.g., *Cannon v. University of Chicago*, 441 U.S. 677, 692 n.13 (1979); *Cort v. Ash*, 422 U.S. 66, 79-80 (1975).

On the other hand, the Code is not meant to be a restatement of the current law, see 2 ALI, FEDERAL SECURITIES CODE § 1716, Comment (6) (1980), and the factors set forth in § 1722 do differ, at least in emphasis, from recent Supreme Court pronouncements. Indeed, in the reporter's comments it is conceded that "the implication of private actions under the SEC statutes would not be easy to square with the Supreme Court's recent emphasis on (a) statutory construction, (b) legislative intention to create a private action (which, to be sure, may be evidenced implicitly), and (c) the *expressio unius exclusio alterius* approach." 2 ALI, FEDERAL SECURITIES CODE § 1722, Comment (2) (1980). To the extent the Code is attempting to sidestep decisions such as *Redington* and *Transamerica Mortgage Advisors* and re-emphasize the *Borak* approach, then the *Baird* rule should be considerably easier to sustain.

206 See 2 ALI, FEDERAL SECURITIES CODE, § 1722, Comment (3) (1980).

is justifiable, there appears to be no reason why Congress cannot, during its current consideration of the Code, address directly the question of exchange liability to public investors. Predetermining liability is traditionally a legislative function and the present re-examination of the securities laws presents Congress an opportunity to heed the Supreme Court and articulate its intent on this and other securities matters.²⁰⁷

V. Conclusion

The basic question surrounding implication of a private right of action for damages against a national securities exchange under section 6 of the Exchange Act is who can best exercise control over exchange conduct, the courts or the SEC. Through a series of recent decisions, the Supreme Court has warned lower courts not to arrogate power by implying private rights of action for statutory violations in the absence of an express congressional mandate. "Absent evidence of clear intent, judicial creation of a private remedy amounts to an assumption or

²⁰⁷ With respect to self-regulatory organizational rules, the Code, in § 1721, provides an express private right of action where such rules have been declared by the SEC to be actionable. Other rules may be recognized as the basis for private actions in accordance with the principle of common law and equity, applied as a matter of federal jurisprudence, unless they have been excluded by Commission rule. Commission rules are binding on the courts, whether such rules are inclusionary or exclusionary.

Section 1721 provides:

(a) DETERMINATION OF RULES TO WHICH SECTION APPLIES.—A member of or participant in a self-regulatory organization who violates a rule of the organization, or a broker, dealer, municipal broker, or municipal dealer within section 905(c) who violates a rule prescribed under that section, is liable to his customer for any loss caused by the violation if—

(1) the rule violated has been determined by Commission rule to be within section 1721; or
(2) a court, except with respect to those rules determined by Commission rule not to be within section 1721, decides that a private right of action under this Code should be recognized in accordance with the principles of common law and equity, applied as a matter of Federal jurisprudence, and the standards of section 1722(a).

(b) COMMISSION'S RULEMAKING AUTHORITY.—The rules of the Commission may designate either specific self-regulatory organization (or section 905(c)) rules or categories of such rules that are or are not within section 1721.

(c) CRITERIA TO GUIDE COMMISSION.—Among the criteria that the Commission shall consider in exercising its authority under section 1721 are (1) whether the particular self-regulatory organization rule was required by the Commission to be adopted, amended, or supplemented, (2) whether the particular rule is substantially a substitute for or parallel to a rule of the Commission (other than a section 905(c) rule), (3) whether the particular rule is designed for the special benefit of a class of persons to which a potential plaintiff belongs against the kind of harm alleged, and (4) the risk, in the case of a self-regulatory organization rule, that the imposition of liability under section 1721 will discourage the organization from full performance of its intended role.

(d) NONRETROACTIVITY.—No rule change adopted by the Commission under section 1721 after a violation has occurred affects an action based on that violation.

The Code seeks to strike a balance between leaving everything to the courts, which would promote uncertainty, and leaving everything to Commission rulemaking, which might invite excessive coverage. See 2 ALI, FEDERAL SECURITIES CODE § 1721, Comment 5 (1980). The author believes that member firms should continue to be liable to their customers when firms violate self-regulatory rules such as those that concern churning, suitability and the like. However, it is the SEC, and not the judiciary, which should be drawing the distinction between actionable and non-actionable rules.

For a review of approaches to the question of implied private rights of action for rule violations, see Rediker, *Civil Liability of Broker—Dealers under SEC and NASD Suitability Rules*, 22 ALA. L. REV. 15 (1969) (arguing that violation of the NASD suitability rule can be used as evidence of fraud but that the NASD rule was no substitute for an SEC rule); Hoblin, *A Stock Broker's Implied Liability to its Customer for Violation of a Rule of a Registered Stock Exchange*, 39 FORDHAM L. REV. 253 (1970) (applying test of Colonial Realty Corp. v. Bache & Co., 358 F.2d 178 (2d Cir.), cert. denied, 385 U.S. 817 (1966), as to whether the organizational rule is basically a substitute for an SEC rule); Lowenfels, *Implied Liabilities Based upon Stock Exchange Rules*, 66 COLUM. L. REV. 12 (1966) (all non-housekeeping rules to be actionable).

usurpation of the legislative function in violation of the separation of powers doctrine."²⁰⁸

Baird v. Franklin and its progeny warrant careful re-examination. The rationale of *Baird v. Franklin* conflicts with the teachings of *Touche-Ross & Co. v. Redington*. Moreover, the existence of a private right of action for damages may place a court or jury in the position of second-guessing SEC decisions regarding exchange supervision and thereby impair, rather than complement, effective regulation of capital markets.

²⁰⁸ See *Leist v. Simplot*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,051 (2d Cir. 1980).